Supreme Court, U.S.
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No.

IN THE
SUPREME COURT OF THE UNITED STATES

In re: ARNOLD I. MEYER, Debtor.

HARRY SHAIA, JR., TRUSTEE,

Petitioner,

v.

ARNOLD I. AND NAOMI A. MEYER,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITION FOR WRIT OF CERTIORARI

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99 pp

I. QUESTIONS PRESENTED

Whether a Bankruptcy Court can set aside an indirect transfer by a debtor to the debtor and his non-bankrupt spouse, which occurs by means of the debtor's pre-payment of two home mortgages, secured by real estate owned by the debtor and his non-bankrupt spouse as tenants by the entireties?

Whether the equity powers of the Bankruptcy Court permit the Bankruptcy Court to find that a debtor's pre-bankruptcy lump sum pre-payment of two home mortgages encumbering a residence owned by the debtor and his non-bankrupt spouse in a tenancy by the entireties was in substance a voluntary transfer to the debtor and his spouse, and avoid such transfer under 11 U.S.C. § 544(b)(1) and Virginia Code § 55-81?

Whether White v. Pacific Mutual, 150 Va. 849, 143 S.E. 340 (1928) and Stigler v. Stigler, 77 Va. 163 (1883) permit the Trustee in bankruptcy to avoid as a voluntary conveyance, payments made by a debtor to pre-pay two home mortgages secured by real estate owned by the debtor and his non-bankrupt spouse, as tenants by the entireties under 11 U.S.C. § 544(b)(1) and Virginia Code § 55-81?

II. PARTIES

All of the parties to the proceeding are identified in the caption of the case.

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V. LOWER COURT CASE CITATIONS

The opinion of the United States Court of Appeals for the Fourth Circuit appears at Appendix ("App.") 1 and is reported at 244 F.3d 352 (4th Cir. March 28, 2001). The order of the United States Court of Appeals for the Fourth Circuit on petition for rehearing and rehearing *en banc* appears at App. 13 and is unpublished (4th Cir. April 24, 2001).

The memorandum opinion and order of the United States District Court for the Eastern District of Virginia appears at App. 15, and is unpublished.

The order and memorandum opinion of the United States Bankruptcy Court for the Eastern District of Virginia appears at App. 38, and is reported at 206 B.R. 410 (Bankr. E.D. Va. 1997).

VI. STATEMENT OF JURISDICTION

Petitioner Harry Shaia, Jr. seeks review of an opinion issued by the United States Court of Appeals for the Fourth Circuit on March 28, 2001. Petitioner Harry Shaia, Jr.'s petition for rehearing and rehearing *en banc* was denied by order of the United States Court of Appeals for the Fourth Circuit filed April 24, 2001. This Court has jurisdiction to issue a writ of certiorari pursuant to 28 U.S.C. § 1254(1).

VII. STATUTORY PROVISIONS

A. 11 U.S.C. § 101(54).

"[T]ransfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.

B. 11 U.S.C. § 105(a).

The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

C. 11 U.S.C. § 522(b)(2)(B), reprinted at App. 61.

D. 11 U.S.C. § 544(b)(1).

Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any

obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

E. Virginia Code § 55-80.

Every gift, conveyance, assignment or transfer of, or charge upon, any estate, real or personal, every suit commenced or decree, judgment or execution suffered or obtained and every bond or other writing given with intent to delay, hinder or defraud creditors, purchasers or other persons of or from what they are or may be lawfully entitled to shall, as to such creditors, purchasers or other persons, their representatives or assigns, be void. This section shall not affect the title of a purchaser for valuable consideration, unless it appear that he had notice of the fraudulent intent of his immediate grantor or of the fraud rendering void the title of such grantor.

F. Virginia Code § 55-81.

Every gift, conveyance, assignment, transfer or charge which is not upon consideration deemed valuable in law, or which is upon consideration of marriage, by an insolvent transferor, or by a transferor who is thereby rendered insolvent, shall be void as to creditors

whose debts shall have been contracted at the time it was made, but shall not, on that account merely, be void as to creditors whose debts shall have been contracted or as to purchasers who shall have purchased after it was made. Even though it is decreed to be void as to a prior creditor, because voluntary or upon consideration of marriage, it shall not, for that cause, be decreed to be void as to subsequent creditors or purchasers.

VIII. STATEMENT OF THE CASE

The Mortgage Pre-Payment

In February 1994, Arnold I. Meyer ("Mr. Meyer") owned real estate in Richmond, Virginia, with his wife Naomi A. Meyer ("Mrs. Meyer") (collectively, "Mr. & Mrs. Meyer") as tenants by the entireties (the "Meyer Home"). App. 4. The Meyer Home was encumbered by two mortgages, jointly owed by Mr. & Mrs. Meyer, which had a combined balance of $168,211.65 (the "Mortgages"). App. 4. At the same time, in addition to the Mortgages, Mr. Meyer owed individual unsecured liabilities of $201,922. App. 41.

In February 1994, Mr. Meyer received a lump sum cash bequest from the estate of his father in the amount of $169,223.71 (the "Bequest"). App.4. The Bequest was Mr. Meyer's individual asset. App. 3. Mr. Meyer deposited the Bequest into a "joint checking account that he shared" with Mrs. Meyer. App. 4. Mr. Meyer the delivered two checks drawn on the joint checking account to pre-pay the Mortgages (the "Pre-Payment"). App. 4. Accordingly, the Mortgages were

released as encumbrances against the Meyer Home. App. 4. As a result, the entire value of the Meyer Home ($175,000 at the time the Mortgages were released) became shielded under Virginia law from the reach of Mr. Meyer's individual creditors in the form of exempt home equity in the Meyer Home, because the Meyer Home was owned as tenants by the entireties. App. 5.

Mr. Meyer's Chapter 7 Bankruptcy Case

Mr. Meyer filed an individual Chapter 7 bankruptcy fifteen months after the Pre-Payment, and claimed exempt his entire interest in the Meyer Home pursuant to 11 U.S.C. § 522(b)(2)(B). App. 5.

The Trustee filed an objection to Mr. Meyer's claimed exemption of his interest in the Meyer Home and an adversary proceeding against Mr. & Mrs. Meyer in which the Trustee sought to recover the Pre-Payment as an avoidable voluntary transfer of Mr. Meyer's asset (the Bequest) to Mr. & Mrs. Meyer without adequate consideration received by Mr. Meyer's individual "estate." App. 5. The Trustee also asserted that the Pre-Payment was a fraudulent conveyance.[1] App. 5. The Trustee relied on the federal "strong arm" provisions of 11 U.S.C. § 544(b)(1), which allowed the Trustee to proceed under Virginia's voluntary and fraudulent conveyance statutes, contained in Virginia Code §§ 55-80 and 55-81. App. 2.

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[1] Since the Bankruptcy Court held that the Pre-Payment was a voluntary conveyance, it did not address whether it was also a fraudulent conveyance, but expressed doubt that the Trustee had proven intent to defraud. App. 52, n. 7.

The Bankruptcy Court's Ruling

Following a one-day trial on November 14, 1996, the Bankruptcy Court ruled that the Pre-Payment was a voluntary conveyance avoidable under 11 U.S.C. § 544(b)(1), and the Virginia voluntary conveyance statute, Virginia Code § 55-81. App. 5-6.

Among other things, the Bankruptcy Court held that (a) the Pre-Payment was a transfer of the Bequest from Mr. Meyer's individual estate into joint equity in the Meyer Home, an asset which was claimed exempt from Mr. Meyer's bankruptcy case, (b) the transfer was made for consideration not deemed valuable in law, (c) the transfer rendered Mr. Meyer insolvent, (d) creditors existed at the time of the transfer who were eligible to avoid the transfer under applicable law, and that (e) it was appropriate to enter a joint and several judgment against Mr. & Mrs. Meyer for the amount of the Bequest, plus pre- and post-judgment interest until paid. App. 43-52. In addition, the Bankruptcy Court authorized the Trustee's sale of the Meyer Home, and imposed an equitable lien on it, pending the sale of the property. App. 52-57.

Explaining its holding that the Pre-Payment was a "transfer," the Bankruptcy Court reviewed federal and state cases applying Virginia's voluntary conveyance statute, including Cramer v. Senger & Tumer, 107 Va. 400, 59 S.E. 375 (1907), and In re Porter, 37 B.R. 56 (Bankr. E.D. Va. 1984). App. 43-47. Thereafter, the Bankruptcy Court found that the Pre-Payment, as a matter of substance, was indistinguishable from the direct and indirect transactions avoided as voluntary conveyances in

those cases. App. 46-47. Acting as a court of equity, and "[k]eeping in mind the equitable principle of 'substance over form,'" the Bankruptcy Court found that:

> by paying each mortgage note, [Mr. Meyer] transformed the cash bequest owned solely by him into equity in real property held by and his wife and himself as tenants by the entirety. The substance of the transaction is [that] property passed from one legal entity (the debtor) to another (the debtor and his wife as tenants by the entirety).

App. 47.

The Bankruptcy Court held further that there was no consideration for the transfer of the Bequest into equity in the Meyer Home and that "[Mr. Meyer] simply made a gift to the tenancy in the form of the satisfied mortgage notes." App. 47-48. The Trustee did not challenge, and the Bankruptcy Court did not disturb, the payments made to the mortgage companies; it was uncontested that the mortgage companies had given adequate consideration for the payments to them by releasing the mortgage notes. App. 47. However, the Bankruptcy Court held that a "second," or indirect transfer of unencumbered home equity to Mr. & Mrs. Meyer as tenants by the entirety was not supported by consideration deemed adequate in law and found this indirect transfer to be a voluntary conveyance. App. 47-48. This was based on the Bankruptcy Court's finding that "the tenancy by the entirety incurred no tangible or intangible legal detriment in exchange for the debtor's payment on its behalf." App. 47.

The District Court's Ruling

Mr. and Mrs. Meyer appealed the decision of the Bankruptcy Court to the District Court. App. 15.

The District Court affirmed each component of the Bankruptcy Court's decision, including the Bankruptcy Court's analysis of the indirect transfer under applicable precedent, noting that:

> Mr. Meyer impermissibly altered the ownership rights in the cash bequest which he received from his father's estate when he used it to pre-pay mortgages which he and his wife owed jointly. In so doing, Mr. Meyer attempted to transfer the cash bequest – his individual, non-exempt asset – from himself to himself and his wife as tenants by the entireties. The transfer of the cash bequest, therefore resulted in a corresponding increase in the equity in the exempt, real property.
>
> Considering the rather fundamental teaching of Cramer and the decisions in Porter and [In re White, 28 B.R. 240, 243 (Bankr. E.D. Va. 1983), relied upon by the court in Porter], it cannot be said that the Bankruptcy Court erred in finding that a transfer occurred and that the transaction should be voided to prevent the creditors from being prejudiced by Mr. Meyer's effort to convert the non-exempt cash bequest into an exempt asset.

App. 24-25.

The District Court also rejected Mr. Meyer's argument that the Pre-Payment was supported by adequate consideration:

> It is clear that Mr. and Mrs. Meyer, as tenants by the entirety, enjoyed the benefit of increased equity in the real property as a result of the mortgage payments. However, Mr. Meyer failed to demonstrate what, if any, detriment he and his wife, as tenants by the entirety, incurred as a result of these payments. The most obvious reason is that there was no detriment. . . . Mr. Meyer's cash payments, therefore, must be considered to be gifts to himself and his wife as tenants by the entirety. The Bankruptcy Court was correct in finding that there was no consideration.

App. 25.

The Fourth Circuit's Ruling

Mr. and Mrs. Meyer appealed the decision of the District Court to the United States Court of Appeals for the Fourth Circuit. App. 2.

The Fourth Circuit reversed the decision of the District Court by adopting a narrower view of the transfers involved in the Pre-Payment transaction. App. 6-12. In evaluating whether the challenged transfer was one which was supported by

consideration deemed adequate in law, the Fourth Circuit held that the Pre-Payment was "***a single transaction*** that was supported by consideration deemed adequate at law." App. 6 (emphasis supplied). The Fourth Circuit then evaluated the district court's reliance on Cramer, supra, White, supra, and Porter, supra, as supporting the application of the Voluntary Conveyance Statute to the second, or indirect, transfer, and rejected those cases as distinguishable and unpersuasive. App. 9-11.

The Fourth Circuit summarized its holding as follows:

> **The transfer in this case, which is sought to be avoided, is the payment of Meyer to the mortgage holders.** Because we hold that transfer was for "consideration deemed valuable in law" under Va. Code § 55-81, we proceed no further with our reasoning in this case. Section 55-81 does not apply, and thus we reject what may be called a second transfer theory, that the payment of the mortgages was itself a second transfer because the land was held by the entireties.

App. 10-11 (emphasis supplied).

IX. ARGUMENT

This case presents the Court with the unusual opportunity to examine and clarify both the scope of the Bankruptcy Court's analysis of an indirect transfer challenged as a voluntary conveyance and the

Bankruptcy Court's use of its equitable powers to conduct that inquiry. Such questions are critical to the Bankruptcy Court's role in resolving debtor-creditor issues at the heart of bankruptcy jurisprudence.

The Bankruptcy Court below, employing familiar equitable principles, concluded that the challenged indirect transfer was, in form, a lump-sum pre-payment of two home mortgages, but in substance, was a voluntary conveyance to the debtor and his non-bankrupt spouse that lacked consideration. Accordingly, the Bankruptcy Court held that the indirect transfer should be avoided and, among other things, entered joint and several judgment against Mr. & Mrs. Meyer. That decision was affirmed by the District Court, but reversed by the Fourth Circuit, which summarily and erroneously concluded, contrary to applicable precedent from this Court and the State of Virginia, that the Pre-Payment effected only one transfer, and was supported by adequate consideration.

The erroneous decision of the Fourth Circuit presents important federal questions which should be considered and decided by the Court.

A. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive Interpretation of "Transfer" Preventing a Bankruptcy Court from Setting Aside an Indirect Transfer and the Court's Prior Decisions Approving the Avoidance of Indirect Transfers.

The national debate over the avoidance of secondary or indirect transfers in bankruptcy began long ago. Under the former Bankruptcy Act of 1898, the Court noted that "circuity of arrangement" would not prevent the avoidance and recovery of property transferred by a bankrupt, the "effect of which is to enable one of his creditors to obtain a greater percentage of his debt than another creditor of the same class." National Bank of Newport v. National Herkimer County Bank, 225 U.S. 178, 184 (1912) (preference avoidance governed not by "mere form or method" of the challenged transfer, but by the disposition by an insolvent debtor of "property to the payment of a creditor's claim"); see also Dean v. Davis, 242 U.S. 438, 442 (1917) (the bank holding an unsecured claim that was paid by the proceeds of a secured loan made by a family member to the debtor was the true recipient of the avoidable preference, not the family member; "[h]ere [the family member] acted on the debtor's behalf in providing the money" used to pay the bank). The Fourth Circuit has similarly observed that "preferences obtained by indirect or circuitous arrangements are to be struck down just as quickly as those obtained by direct arrangements."

Aulick v. Largent, 295 F.2d 41, 52 (4th Cir. 1961) (preference avoided under Bankruptcy Act).[2]

More recently, the debate erupted again in the arena of preference avoidance, this time in the context of the liability of a non-insider creditor for payments benefiting an insider made within the insider preference period (1 year before bankruptcy filing), but beyond the non-insider preference period (90 days before bankruptcy filing). A defining case in this debate was Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186 (7th Cir. 1989), in which the Seventh Circuit held that a transfer to a non-insider creditor that conferred a benefit on an insider was avoidable in an action against the non-insider, when the bankruptcy was filed within the insider preference avoidance period (1 year before bankruptcy filing), but beyond the non-insider preference avoidance period (90 days before bankruptcy filing). The Seventh Circuit in Levit discussing its rejection of the Bankruptcy

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[2] In Aulick, the Fourth Circuit offered this explanation of its analysis of the transfer avoided as preferential in that case:

> *[i]f the bankrupt had delivered the shares of stock to Mrs. Aulick as security for the payment of her antecedent debt, she would have received a voidable preference* just as the transfer of stock to Lemley was a voidable preference. *She cannot do indirectly what she could not do directly* and destroy the protection provided by [the Bankruptcy Act preference section] for other creditors represented by the trustee in bankruptcy.

295 F.2d at 52 (emphasis supplied).

Although the Bankruptcy Court did not cite Aulick as authority, it made a similar finding in this case. App. 46-47.

Court's "two transfer" holding, explained its analysis as follows:

> [t]he two-transfer approach equates "transfer" with "benefit received." Both Lender and Guarantor gain from payment, and each receives a "transfer" to the extent of the gain. The [Bankruptcy] Code, however, equates "transfer" with payments made. Section 101(50) . . . says that a transfer is a disposition of property. Sections 547 and 550 both speak of a transfer being avoided; avoidability is an attribute of the transfer rather than of the creditor. While the lenders want to define transfer from the recipients' perspectives, the Code consistently defines it from the debtor's. A single payment therefore is one "transfer," no matter how many persons gain thereby.

874 F.2d at 1195-96.[3]

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[3] There was no Circuit-level conflict with the Seventh Circuit's analysis in Levit. See, e.g., In re Meredith Hoffman Partners, 12 F.3d 1549, 1557-58 (10th Cir. 1994); In re Suffola, 2 F.3d 977, 981-82 (9th Cir. 1993); In re T.B. Westex Foods, Inc., 950 F.2d 1187, 1193-95 (5th Cir. 1992); In re H & S Transportation Company, Inc., 939 F.2d 355, 358-360 (6th Cir. 1991); In re C-L Cartage Co., Inc., 899 F.2d 1490, 1494-95 (6th Cir. 1990). However, the preference liability imposed on the non-insider creditor for these payments was widely perceived to be unfair and led ultimately to the amendment of Section 550(c) of the Bankruptcy Code in an effort to reverse or ameliorate the holding in Levit. See 11 U.S.C. § 550(c)(2000).

Even the Seventh Circuit in Levit recognized, however, that insiders remained liable for transfers from which they benefited and that a trustee could pursue either the benefited insider, the non-insider recipient of the payment, or both. 874 F.2d at 1194-97.[4]

The debate in this arena was largely silenced by the amendment of Bankruptcy Code Section 550(c) in a manner which precluded recovery of an avoided preference from a non-insider, where the transfer was made for the benefit of an insider, but the transfer occurred between 90 days and one year before the bankruptcy filing. See 11 U.S.C. § 550(c)(2000).

In this case, the debate surfaced again in the context of an action by the Trustee seeking to avoid transfers made by a debtor that resulted in the conferring of a benefit to the debtor and his non-bankrupt spouse without consideration, as a voluntary conveyance under applicable state law. Here, the Trustee sought to avoid the Pre-Payment as a voluntary conveyance, proceeding under Bankruptcy Code Section 544(b)(1), which allows the Trustee to avoid any transfer that might be challenged by a creditor under applicable law, here the law of the State of Virginia.

Although a debtor's making of regular, monthly, home mortgage payments prior to bankruptcy is not

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[4] Overlaying this analysis on the present case, the Trustee could have sued Mr. & Mrs. Meyer (who benefited from the transfer in this case), the mortgage companies, or both. The Trustee chose to sue only Mr. & Mrs. Meyer, the parties who benefited from the transfer in this case.

remarkable, the size and result of the Pre-Payment in this case were unusual and suspect. These were not routine, monthly mortgage payments to a mortgage creditor; these were large lump-sum pre-payments of the entire balances of two mortgages on a financially distressed debtor's home, using funds which were indisputably the debtor's sole property. Moreover, the result of the Pre-Payment was even more striking: because the mortgages were pre-paid, and the Meyer Home was owned by Mr. & Mrs. Meyer as tenants by the entireties, Mr. Meyer claimed the entire value of the Meyer Home exempt from the bankruptcy estate when he filed individual bankruptcy, without his wife, pursuant to 11 U.S.C. § 522(b)(2)(B)(2000). Thus, the debtor's individual estate was depleted at the same time the debtor was securing the total release of all mortgages on the home owned jointly with his wife as tenants by the entireties, enabling it to be claimed exempt from the claims of his individual creditors when he later filed individual bankruptcy.

The Trustee asserted that by making the Pre-Payment, Mr. Meyer sought to accomplish indirectly what he could not accomplish directly. That is to say that if Mr. Meyer had taken the amount of the Pre-Payment and instead had purchased a new house with those funds, which he titled in the name of himself and his wife as tenants by the entireties, that transfer (to himself and his wife as tenants by the entireties) would have been avoided as a voluntary or fraudulent conveyance. In re Porter, 37 B.R. 56, 60 (Bankr. E.D.Va. 1984), citing In re White, 28 B.R. 240 (Bankr. E.D.Va. 1983). The Trustee argued that Mr. Meyer should not be permitted to effect the same result merely by pre-paying mortgages on his existing home, causing a release of equity to and conferring a

gratuitous benefit upon Mr. & Mrs. Meyer in their tenancy by the entirety, to the disadvantage of Mr. Meyer's individual creditors.

Two prior bankruptcy court decisions addressed similar fact situations, with different results. The Bankruptcy Court in In re Covino, 187 B.R. 773 (Bankr. S.D. Fla. 1995) held that a debtor's pre-payment of his home mortgage was an impermissible conversion of a non-exempt asset (cash settlement proceeds) into an exempt asset (equity in a home), avoided the transfer as a fraudulent conveyance and imposed an equitable lien against the home to secure repayment of the avoided transfer. The Bankruptcy Court in In re Theisen, 45 B.R. 122 (Bankr. D. Minn. 1984), found that a debtor's pre-payment of a seller's lien against his home was supported by fair consideration and denied the trustee's claim that the pre-payment was in fact a voluntary conveyance from the debtor into his "homestead," describing the trustee's challenge to the transfer as "strained." Id. at 127.

The Fourth Circuit's view of the present case was that the "transfer in this case, which is sought to be avoided, is the payment of Meyer to the mortgage holders." App. 10. That view reflects a fundamental misunderstanding by the Fourth Circuit of the Trustee's action as being directed at the mortgage companies. The Trustee did not challenge the Pre-Payment to the mortgage companies and those companies were not parties to the proceeding below. Instead, the Trustee sought to recover the value of the Pre-Payment from the parties who directly and gratuitously benefited from that Pre-Payment: Mr. & Mrs. Meyer. It was Mr. & Mrs. Meyer whose tenancy by the entirety swelled in value by the amount of the

Pre-Payment, all of which was claimed exempt from the claims of Mr. Meyer's individual creditors.

The Bankruptcy Court and the District Court correctly analyzed and properly applied the law applicable to avoiding indirect payments under these facts, consistent with the principles laid down in National Bank of Newport, supra, Dean v. Davis, supra and Aulick, supra. The decisions of the Bankruptcy Court and the District Court correctly prevented Mr. Meyer from accomplishing indirectly what the law would not permit him to accomplish directly. The decision of the Fourth Circuit below conflicts with these principles and should be reversed.

The Trustee submits that the resolution of these issues relating to the avoidance of indirect transfers by the bankruptcy court presents an important federal question relating to bankruptcy jurisprudence which should be decided by the Court.

B. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive Interpretation of "Transfer" and the Court's Prior Decisions Outlining the Scope of the Bankruptcy Court's Equitable Powers and Provide Guidance to Lower Federal Courts in the Proper Exercise Of Those Powers.

The Fourth Circuit's decision also conflicts with decisions of the Court outlining the scope and application of the Bankruptcy Court's equitable powers.

Bankruptcy Courts are courts of equity. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1983); Katchen v. Landy, 382 U.S. 323, 327 (1966); Pepper v. Litton, 308 U.S. 295, 304 (1939). As such, the Bankruptcy Court's equitable powers are properly "invoked to the end that . . . substance will not give way to form [and] that technical considerations will not prevent substantial justice from being done." Pepper v. Litton, 308 U.S. at 304-5; In re A.H. Robins Company, Inc., 880 F.2d 694, 702 (4th Cir. 1989) (citing MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 94 (2d Cir. 1988)); Brockington v. Scott, 381 F.2d 792, 794 (4th Cir. 1967) ("recognition of substance over form" is "appropriate in bankruptcy proceedings" to avoid a "windfall" to one party at the expense of creditors).

In Pepper v. Litton, supra, the Court noted that "bankruptcy courts have exercised . . . equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates." 308 U.S. at 304-5. In Pepper, the Court considered and reversed a decision by the Fourth Circuit, and, among other things, held that the Bankruptcy Court's power to evaluate the validity of an insider's claim was not barred by the "mere fact" that the claim had been reduced to judgment in a state court. Id. at 305-7. Instead, the Court encouraged the Bankruptcy Court to "look behind the judgment to determine the essential nature of the liability for purposes of proof and allowance," and noted that "[i]n the exercise of its equitable jurisdiction, the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate." Id. at 307-8. Moreover, since Pepper involved stockholder self-dealing and a "planned and fraudulent scheme," the

Court observed that once the nature of the scheme was uncovered:

> it was the duty of the bankruptcy court in the exercise of its equity jurisdiction to undo it. Otherwise, the fiduciary duties of dominant or management stockholders would go for naught; exploitation would become a substitute for justice; and equity would be perverted as an instrument for approving what it was designed to thwart.

308 U.S. at 312.

In this case, the Trustee submits that once the Bankruptcy Court concluded that in substance the Pre-Payment was actually a transfer from Mr. Meyer to Mr. & Mrs. Meyer that was avoidable under Virginia law as a voluntary conveyance, the Bankruptcy Court was duty-bound to disregard the form of the transaction; to avoid the voluntary transfer; and to enter such orders consistent with its equitable analysis as would render substantial justice in the case.

In holding that the Pre-Payment was a transfer avoidable under the Virginia voluntary conveyance statute, the Trustee submits that the Bankruptcy Court correctly applied the equitable mandate of Bankruptcy Courts to look to substance, not form, guided by equitable principles articulated in Pepper, supra, Cramer, supra, Porter, supra, and White, supra and consistent with the decisions of the Virginia Supreme Court in Pacific Mutual, infra, and Stigler, infra. Applying these principles, the Bankruptcy

Court and the District Court concluded that the Pre-Payment was, in substance, a gift by Mr. Meyer of the Bequest to Mr. and Mrs. Meyer as tenants by the entireties, by the vehicle of pre-paying the home mortgages.

Nowhere in the Fourth Circuit decision was this conclusion questioned. Substantial justice requires that the decision of the Fourth Circuit be reversed. Otherwise, the effect of the Fourth Circuit decision is to materially impair, if not substantially undermine, the equitable powers of the Bankruptcy Court that are critical to the even-handed administration of bankruptcy jurisprudence.

Although the Fourth Circuit suggests that its decision is necessary to avoid disruption to transactions involving home mortgages, it did not consider the far-reaching effects of its analysis of the transfer to many other areas of bankruptcy and debtor-creditor law. By elevating the form of the transfer at issue in this case over its substance, the Fourth Circuit provided a cure that is far worse than any imaginable ills of the lower courts' judgments.[5]

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[5] For example, the Fourth Circuit decision emphasizes that it is limited to the facts of this case involving an alleged voluntary conveyance sought to be avoided under Va. Code § 55-81 and did not address the issues presented by the Trustee's additional claim (not reached by the Bankruptcy Court) that the transaction was also a fraudulent conveyance challenged under Va. Code § 55-80. However, the existence of a "transfer" is required for either a voluntary or a fraudulent conveyance to have occurred. See Va. Code §§ 55-80, 55-81. The Fourth Circuit's decision flatly rejects the "second transfer theory" alleged by the Trustee that "the payment of the mortgages was itself a second transfer because the land was held by the entireties." App. 10-11.

The potential for mischief presented by the decision of the Fourth Circuit can readily be seen when one considers whether it will now ever be possible in the Fourth Circuit for a bankruptcy trustee to avoid any type of payment of a secured debt, where the collateral is owned by the entireties, even if the payment is made with the express purpose to hinder, delay or defraud creditors. This is because the Fourth Circuit holds that when the debtor makes a mortgage payment there is only one transfer (to the mortgage company) and the resulting increase in equity in the collateral entireties property is not a transfer.[6]

The Fourth Circuit's decision in this case elevates form over substance, ignores the equitable findings and analysis of the Bankruptcy Court and the District Court, and effectively insulates all pre-payments of secured debt on entireties property, even where the size, circumstances or the express or implied intent of the transferor demonstrate that the

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[6] The manner of ownership of the collateral property is significant here. If the collateral property is owned individually by the debtor who makes the payment, then the reduction of the secured creditor's lien against the property operates as a return of equivalent value to the debtor's estate. Thus, the creditors of the individual debtor are not harmed by the transfer. However, where the collateral is held jointly with a spouse in a tenancy by the entireties, then when the secured creditor's loan is reduced (or, as here, satisfied), the equity which is created inures not to the debtor making the payment, but to the debtor and his spouse as tenants by the entireties. Thus, in this case, where one co-debtor makes a large pre-payment and converts an individual asset into an entireties asset, that co-debtor's individual creditors are deprived of what they would have been entitled to prior to the payment and the transfer becomes insulated in the hands of the tenants by the entireties. Such an outcome is manifestly unjust to the creditors of the spouse who makes the transfer, however attractive it may be as an insolvency planning device.

pre-payment was fraudulent or lacked any consideration deemed valuable in law. This result is inconsistent with Pepper v. Litton, supra, in which the Court directed that "substance will not give way to form [and], that technical considerations will not prevent substantial justice from being done." 308 U.S. at 305.

This case presents the Court with a significant opportunity to resolve a conflict between the Court's prior holdings relating to the Bankruptcy Court's equity powers and the Fourth Circuit's decision in this case and to provide suitable guidance to lower federal courts in the proper exercise of those powers.

C. The Court Should Resolve the Conflict Between the Fourth Circuit's Restrictive and Formalistic Interpretation of "Transfer" and the Virginia Supreme Court's Decisions in Pacific Mutual and Stigler, Where Substance Prevailed over the Form of the Transaction Subject to Avoidance.

Finally, the Fourth Circuit's decision also conflicts with two well-established decisions from the Supreme Court of Virginia. White v. Pacific Mut. Life Ins. Co., 150 Va. 849, 143 S.E. 340 (1928); Stigler v. Stigler, 77 Va. 163 (1883).

White v. Pacific Mut. Life Ins. Co., 150 Va. 849, 143 S.E. 340 (1928), and Stigler v. Stigler, 77 Va. 163 (1883) both involved insurance policies and claims by creditors of a decedent against the proceeds of the policies which were in the hands of or destined for the decedent's surviving spouse. In each case, the

Virginia Supreme Court held that a decedent's payment of premiums, while insolvent, on policies of insurance which benefited a surviving spouse was a voluntary conveyance and would be avoided, up to the amount of the premium payment. 150 Va. at 862; 77 Va. at 168-69. Avoidance was required, despite the fact that there was clear and undisputed "consideration" which flowed from the primary transferee (the insurance company) to the debtor to support the payment. In both Pacific Mutual and Stigler, the Virginia Supreme Court held that creditors were entitled to recover the amount of the premium payments out of the proceeds of the policy received by or for the benefit of the decedent's spouse as voluntary conveyances. Id.

In Pacific Mutual, the Supreme Court of Virginia quoted from Lile's Notes on Equity Jurisprudence, where it was said that:

> [t]he payment of such premiums, while insolvent, is manifestly a *voluntary transfer of property without providing for existing debts* – and seems clearly within the terms of the [voluntary conveyance] statute. We have already seen that if the insolvent settles *houses and lands,* or *money,* or *securities,* directly upon his wife, when not bound thereto by antenuptial contract, equity will let in existing creditors upon the property. No difference is perceived where he settles an *insurance policy* upon her, and devotes money which should go to his creditors to the payment of premiums on the policy.

> **"In Virginia it is settled that under our statute of voluntary conveyances, premiums thus paid on a policy of insurance for the benefit of another, are within the purview of the statute; and that existing creditors of the insured may subject the proceeds of the policy after death of the insured,** *to the extent of the premiums so diverted* **and within the period permitted by the statute of limitations (five years in Virginia, in the case of a purely voluntary conveyance)."**

150 Va. at 862 (italics in original; emphasis added).

Lile cited Stigler v. Stigler, supra, in support of his statement of Virginia law, which the Virginia Supreme Court discussed in Pacific Mutual:

> In [Stigler] each of the policies was intended as a gift to accrue to the beneficiaries therein named. When the premiums on them were paid, the insured was indebted. The obvious intent of the statute is to invalidate as against existing claims of creditors every gift or voluntary assignment of the debtor's property, **without regard to its object or the form in which it is made.** It is plain therefore, that to the extent the means of the insured were withdrawn from creditors and applied to the payment of premiums on the policies in question, the payments were void as

> against creditors, and that they were entitled to have the sums so paid applied to the discharge of their claims, out of the proceeds of the policies. . . **because when [the decedent] paid the premiums, he was using his creditors' money; money which they had the right to demand should be paid on their debts.**

Id. at 862-63 (emphasis added).

The holdings of the Virginia Supreme Court in Pacific Mutual and Stigler, plainly show that: (1) Virginia's voluntary conveyance statute requires analysis of the secondary, or indirect, effects of a debtor's transfer of assets to third parties; (2) under Virginia's voluntary conveyance statute, the secondary or indirect transfer can be avoided and assets can be recovered from the proceeds of that transfer, even where the primary or initial transfer was amply supported by "consideration deemed adequate in law," and (3) the modest amount, routine nature, or societal benefit of underlying transfers do not warrant an exception of the challenged transaction from the application of Virginia's voluntary conveyance statute.

Applied to the facts of this case, the Trustee submits that Pacific Mutual and Stigler demonstrate that the Fourth Circuit clearly erred in (a) focusing exclusively on the primary transfer to the mortgage companies, (b) holding that Virginia's voluntary conveyance statute did not apply to the indirect transfer of the Pre-Payment (a non-exempt asset) into equity in the entireties real estate (an exempt asset) which the Trustee sought to avoid in this case, and (c) analyzing the adequacy of consideration merely at the

level of the first or superficial transfer, and not (from the perspective of the creditors of Mr. Meyer) as against the secondary or indirect transfer.

The Court has considered important federal questions presented within bankruptcy cases, even where those issues involved the application of state law to a particular issue arising in a bankruptcy case. See Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000) (Illinois use tax); Fidelity Financial Services, Inc. v. Fink, 522 U.S. 211 (1998) (perfection of motor vehicle security interest under Missouri law); Citizens Bank of Maryland v. Strumpf, 516 U.S. 16 (1995)(right of setoff under Maryland law); BFP v. Resolution Trust Corporation, 511 U.S. 531 (1994)(state foreclosure law); Barnhill v. Johnson, 503 U.S. 393 (1992)(New Mexico Commercial Code-Article 3).

The Trustee submits that this case presents a proper and important federal question arising in the context of the Fourth Circuit's failure to properly apply the law of Virginia to the facts of this case.

X. CONCLUSION

For the foregoing reasons, the Trustee respectfully requests that the Court issue a writ of certiorari to the United States Court of Appeals for the Fourth Circuit in this case.

HARRY SHAIA, JR., TRUSTEE

/s/ James J. Burns

By _____
Counsel

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July 23, 2001

PUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

In Re: ARNOLD I. MEYER, *Debtor.*	
HARRY SHAIA, JR., Trustee, *Plaintiff-Appellee,*	No. 98-1534
v.	
ARNOLD I. MEYER; NAOMI A. MEYER, *Defendants-Appellants.*	

Appeal from the United States District Court
for the Eastern District of Virginia, at Richmond.
Robert E. Payne, District Judge.
(CA-97-352, BK-95-32427-DOT, AP-96-3006)

Argued: March 4, 1999

Decided: March 28, 2001

Before WIDENER, LUTTIG, and MICHAEL, Circuit Judges.

Vacated and remanded by published opinion. Judge Widener wrote the opinion, in which Judge Luttig and Judge Michael jointed.

COUNSEL

ARGUED: Bruce H. Matson, LECLAIR RYAN, P.C., Richmond, Virginia, for Appellants. James Joseph Burns, WILLIAMS, MULLEN, CHRISTIAN & DOBBINS, Richmond, Virginia, for Appellee.

ON BRIEF: Paula Steinhilber Beran, LECLAIR RYAN, P.C., Richmond, Virginia, for Appellants. Patrick R. Hanes, WILLIAMS, MULLEN, CHRISTIAN & DOBBINS, Richmond, Virginia, for Appellee.

OPINION

WIDENER, Circuit Judge:

Defendants, Arnold and Naomi Meyer, appeal the district court's judgment in favor of plaintiff, Harry Shaia, Jr. (trustee), in a bankruptcy proceeding pursuant to 11 U.S.C. § 544(b). The district court affirmed the bankruptcy court's holding that Meyer's pre-payment of mortgages on real property owned by himself and his wife as tenants by the entirety with funds he was bequeathed under the will of his father was an avoidable voluntary conveyance under Virginia Code § 55-81. The district court further affirmed the bankruptcy court's joint and several judgment against

the Meyers in the amount of the mortgage pre-payment plus interest costs.

We emphasize at the outset that the *only* question before us is whether or not the pre-payment of the previously existing secured mortgage obligation is a voluntary conveyance which may be set aside under Virginia Code § 55-81. That Code section provides, in pertinent part, that

> Every gift, conveyance, assignment, transfer or charge which is not upon consideration deemed valuable in law, or which is upon consideration of marriage, by an insolvent transferor, or by a transferor who is thereby rendered insolvent, shall be void as to creditors whose debts shall have been contracted at the time it was made, but shall not, on that account merely, be void as to creditors whose debts shall have been contracted or as to purchasers who shall have purchased after it was made.

Va. Code § 55-81. To avoid a transfer pursuant to this provision, the trustee must demonstrate that (1) a transfer was made, (2) the transfer was not supported by consideration deemed valuable in law, and (3) the transfer was done when the transferor was insolvent or the transfer rendered the transferor insolvent.

The transfer which was made was the payment of the mortgages from the personal funds of Meyer. That is acknowledged. The holding of the bankruptcy court, that the payment to the mortgage note holders rendered Meyer insolvent, was affirmed by the district

court on appeal, and is not contested on appeal to this court. Therefore, the only issue here is whether or not the payment of the mortgage notes was supported by "consideration deemed valuable in law." We are of opinion that the payment of the mortgage notes was supported by consideration deemed valuable in law. Thus, we vacate the judgment of the district court and remand for further proceedings, should the trustee be so advised.

By deed dated October 1, 1973, the Meyers acquired their residence as tenants by the entirety with the right of survivorship as at common law. By February 1994, the Meyers' residence was encumbered with secured mortgage obligations that totaled $168,211.65. In addition to these mortgages, Meyer was responsible for several unsecured debts that he had obtained through the years to support his various business ventures. Meyer was in default on his repayments to several of these unsecured creditors.

On September 12, 1993, Meyer's father died testate. The father's will contained a specific bequest to Meyer, individually, of a "sum equal to the remaining principal balances, if any, of all mortgages upon . . . [Meyer's] principal residence" at the time of the father's death (the cash bequest). The exact amount of the bequest was $169,223.71. Meyer deposited the cash bequest into a joint checking account that he shared with his wife. Then, on February 27 and 28, 1994, Meyer delivered two checks in the total amount of $168,211.65 to the mortgage creditors (the mortgage pre-payment). Upon receipt of the mortgage pre-payment, the creditors released their security interests in the Meyers' residence.

Meyer's financial situation worsened throughout 1994, and on June 13, 1995, he declared bankruptcy under Chapter 7 of the Bankruptcy Code. Upon reviewing the bankruptcy schedules filed by Meyer, the trustee discovered that Meyer had used most of the substantial cash bequest to prepay and satisfy two mortgages secured by his residence that he co-owned with his wife as tenants by the entirety. Meyer claimed that this residential property was exempt from his creditors in the bankruptcy proceedings pursuant to 11 U.S.C. § 522(b)(2)(B). The trustee objected to Meyer's claimed exemption of the residence and filed a complaint in an adversary proceeding against the Meyers on January 5, 1996. The complaint asserted that, by the payment of the mortgage on the residence, the transfer of the debtor's individual nonexempt cash bequest into an exempt interest in the residential real property constituted both a voluntary conveyance under Va. Code § 55-81 and a fraudulent conveyance under Va. Code § 55-80.

The bankruptcy court determined that when Meyer made the pre-payments of the two mortgages, two distinct transfers occurred simultaneously. *Shaia v. Meyer*, 206 B.R. 410, 416 (Bankr. E.D. Va. 1997). First, there was a transfer from Meyer to the mortgage creditors. Second, there was a transfer from Meyer to the tenancy by the entirety as a result of the increased equity in the residence that occurred when the residence was freed of all encumbrances. *Shaia*, 206 B.R. at 416. The court held that the second transfer was not supported by valuable consideration and avoided the mortgage pre-payment as a voluntary

conveyance under Va. Code § 55-81. *Shaia*, 206 B.R. at 417.*

The Meyers appealed the bankruptcy court's judgment, and the district court affirmed. The court stated that "Mr. Meyer attempted to transfer the cash bequest, his individual, nonexempt asset, from himself to himself and his wife as tenants by the entireties. The transfer of [the] cash bequest, therefore, resulted in a corresponding increase in the equity in the exempt, real property." The court concluded that the mortgage pre-payment "should be voided [as a voluntary conveyance] to prevent the creditors from being prejudiced by Mr. Meyer's effort to convert the nonexempt cash bequest into an exempt asset." We disagree with the district court's application of the voluntary conveyance statute and hold that the mortgage pre-payment was a single transaction that was supported by consideration deemed valuable in law.

As there are no factual issues in dispute, we review the district court's legal conclusions de novo. See *Yancey v. Varner (In re Pucci Shoes, Inc.)*, 120 F.3d 38, 40-41 (4th Cir. 1997). The Bankruptcy Code provides that a trustee in bankruptcy "may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an [allowable] unsecured claim." 11 U.S.C. § 544(b)(1). The litigants agree that Virginia law is the applicable law in this proceeding.

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* Because the bankruptcy court avoided the mortgage pre-payment as a voluntary conveyance it did not address the trustee's argument that the transaction also was voidable as a fraudulent conveyance under Va. Code § 55-80. *Shaia*, 206 B.R. at 418 n.7.

Va. Code § 55-81 simply requires that a transfer or conveyance be "upon consideration deemed valuable in law." This phrase refers to "*any* valuable consideration received by the transferor." See *Moore v. Manson (In re Springfield Furniture, Inc.)*, 145 B.R. 520, 533 (Bankr. E.D. Va. 1992). Here, the parties agree that Meyer transferred $168,211.65 to his mortgage creditors in satisfaction of his outstanding debt. In return for this payment, the creditors released their secured claims to the Meyers' property. The creditor's release of secured debt against his property is surely valuable consideration that Meyer received in return for pre-paying the mortgage. See also *Bergquist v. Theisen*, 45 B.R. 122, 127 (Bankr. D. Minn. 1984) (holding that payment of antecedent secured debt was "fair consideration" and rejecting a second transfer theory which claimed, as here, that payment of a secured debt on real estate subject to homestead exception was a voidable transfer to exempt property).

Two cases decided by district courts in Virginia are consistent with our decision as to a "consideration deemed valuable in law" under Va. Code § 55-81. *In Inspiration Coal, Inc. v. Mullins*, 690 F. Supp. 1502 (W.D. Va. 1988), the question was whether deeds of trust given by Mullins to secure antecedent indebtedness of Mullins to the two banks involved met the requirements of the statute. Relying on a line of Virginia cases, e.g., *Bank of Commerce v. Rosemary & Thyme, Inc.*, 239 S.E.2d 909, 912 (Va. 1978), holding that an antecedent debt is valuable consideration for a conveyance of land, the court held that the antecedent debt of Mullins to the banks was consideration deemed valuable in law under § 55-81, precisely the same Code section involved here. *C-T of Virginia v.*

Euroshoe Associates, 762 F. Supp. 675 (W.D. Va. 1991, aff'd, 953 F.2d 637 (4th Cir. 1992) (table), was a case involving a leveraged buyout of a shoe manufacturing company. The new controlling shareholders set up a third corporation to furnish funds, which new corporation purchased all of the outstanding shares of C-T, the original shoe manufacturing company. The form of the transfer was payment by C-T to its shareholders. Following the bankruptcy of C-T, it sought to set aside the purchase of its own shares because they were not for consideration deemed valuable in law under § 55-81. Following *Inspiration Coal*, the court held that the shareholders received money for their stock and the holding company received control of C-T, which, in the opinion of the court, was consideration deemed valuable in law. The court pointed out that C-T "gained something, and that is enough to prevent avoidance of a transaction." *C-T of Virginia*, 762 F. Supp. at 678.

Inspiration Coal relied on *Mitchell Powers Hardware Co. v. Eaton*, 198 S.E. 496 (Va. 1938), which held that a note secured by a pledge of stock given by a man to his sister was for a consideration deemed valuable in law when the consideration for the note was that she would perform the man's duty of keeping up his aged mother.

The district court, however, proceeded further in its analysis of the transaction. As a result of Meyer's mortgage pre-payment, the equity in his residence increased because the property was no longer encumbered with the secured mortgages. Consequently, the district court found that through the mortgage payment Mr. Meyer transformed the cash bequest (nonexempt property) owned solely by

himself into equity in real property (exempt property) held by both himself and his wife. The district court adopted the bankruptcy court's conception of the transfer as one in which Meyer's mortgage payments effected one transfer under Va. Code § 55-81 to the mortgage creditors and a second transfer under § 55-81 to the tenancy by the entirety. The court then avoided the mortgage pre-payment as a voluntary conveyance on the basis that the second transfer to the tenancy by the entirety was without consideration deemed valuable in law.

In reaching this conclusion, however, the district court misapplied the voluntary conveyance statute. It relied on three cases for its conclusion, *Cramer v. Senger & Tumer*, 59 S.E. 375 (Va. 1907); *In re: White*, 28 B.R. 240 (Bankr. E.D. Va. 1983); and *In re: Porter*, 37 B.R. 56 (Bankr. E.D. Va. 1984). These cases, however, are on facts so different from the case at hand that they are not persuasive. In *Cramer*, a husband who was subject to a judgment recovered against him in a state court, caused to be conveyed to his wife ten acres of land to which he was entitled. The court held this conveyance was "nothing more than a gift" and void as to his creditors, affirming the lower court which had ordered the ten acres of land sold to satisfy the said judgment against Cramer in the state court. *Cramer*, 59 S.E. at 377. Both *White* and *Porter* involved cases in which a man who owned real estate in his own name had conveyed the real estate to himself and his wife as tenants by the entireties. In *White* the court held that "White was insolvent at the time he transferred his interest in the real estate to himself and his wife, for which he received nothing of legal value in payment." *White*, 28 B.R. at 243. White being insolvent at the time of the conveyance, and having a previous judgment of record

against him, the court held that the transfer constituted a fraudulent conveyance pursuant to 11 U.S.C. § 548(a)(2)(B)(i) (transferor insolvent on the date the transfer was made). In *Porter*, following a finding of liability in a state court, but before judgment was entered in the amount of the liability, Porter conveyed the real estate involved to himself and his wife as tenants by the entireties. The property was valued at $88,000 at the time, and the consideration was claimed to be wills executed by husband and wife, disposing of the entire estate of each to the other and various items of personal property valued at $2,245. The wife testified, however, that the bankrupt husband would have transferred the house into both their names "even if she had not transferred anything of value to him in exchange." 37 B.R. at 59. Under those circumstances, the bankruptcy court held that there was not "a reasonable equivalent value in exchange for such transfer" under 11 U.S.C. § 548(a)(2)(A) or a "valuable consideration" under Va. Code § 55-80, or a "consideration deemed valuable in law" under Va. Code § 55-81. *Porter*, 37 B.R. at 69. The facts of none of those cases deal with the payment of a pre-existing mortgage debt on property held by the entireties, and we are of opinion they are not persuasive in this case. Rather, we follow the cases of *Inspiration Coal, Inc.*, *C-T of Virginia*, and the line of cases illustrated by *Bank of Commerce* as we have mentioned above. The transfer in this case, which is sought to be avoided, is the payment of Meyer to the mortgage holders. Because we hold that transfer was for "consideration deemed value in law" under Va. Code § 55-81, we proceed no further with our reasoning in this case. Section 55-81 does not apply, and thus we reject what may be called a second transfer theory, that the payment of the mortgages

was itself a second transfer because the land was held by the entireties.

In arriving at our decision, we are reminded of the almost unimaginable consequences of affirming the holding below in this case, that the payment by one who is insolvent or rendered insolvent, of a pre-existing mortgage debt on property held by the entireties, is not for a "consideration deemed valuable in law" under Va., Code § 55-81. We do not know, of course, what proportion of the homes in Virginia are held by husband wife by the entireties, but half would be an estimate, not subject to reasonable dispute. If we affirmed the holding below, every time one spouse filed for bankruptcy each payment on the mortgage on a property held by the entireties made while the spouse was insolvent, or which rendered the spouse insolvent, would be void as to previous creditors. The result would be chaotic, at best.

When questioned at oral argument with respect to this effect as to monthly payments on mortgages on homes and automobiles held by the entireties, the trustee, as a part of an answer to a question, stated:

I think it's a difference of degree.

Q: Your answer is that trustees just aren't going to bother with the small things.

A: That is my answer.

According to Sheshunoff, *Bank and S&L Quarter*, however, the September 1999 United States domestic mortgage debt to banks was $1,510.3 billion. Even the monthly payments on Virginia's pro-rata

share, $38.3 billion, is hardly a small thing. And we have not considered the billions in loans not from banks. That argument also does not support the conclusion of the district court.

The judgment of the district court is accordingly vacated, and the case is remanded for further action not inconsistent with this opinion, should the trustee be so advised.

VACATED AND REMANDED

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

FILED April 24, 2001

No. 98-1534
CA-97-352
BK-95-32427-DOT
AP-96-3006

In Re: ARNOLD I. MEYER

Debtor

HARRY SHAIA, JR., Trustee

Plaintiff - Appellee

v.

ARNOLD I. MEYER; NAOMI A. MEYER

Defendants - Appellants

On Petition for Rehearing and Rehearing En Banc

The appellee's petition for rehearing and rehearing en banc was submitted to this Court. As no member of this Court or the panel requested a poll on the petition for rehearing en banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and rehearing en banc is denied.

For the Court,

/s/ Patricia S. Connor
CLERK

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF VIRGINIA
Richmond Division

In re: ARNOLD MEYER

Debtor.

ARNOLD I. MEYER
NAOMI A. MEYER

Appellants,

v. Civil Action No. 3:97cv352

HARRY SHAIA, JR.,

Trustee- Appellee.

MEMORANDUM OPINION

This appeal asserts that the Bankruptcy Court erred in the determination that the debtor had engaged in a voluntary transfer which was voidable under Va. Code § 55-81. The transfer at issue occurred when the debtor, in his individual capacity and with nonexempt funds, made a pre-petition payment toward satisfaction of a debt which was owed jointly by him and his wife and which was secured by exempt realty that they owned as tenants by the

entirety. For the reasons set forth below, the judgment of the Bankruptcy Court is affirmed.

PROCEDURAL BACKGROUND

In February 1994, Arnold I. Meyer ("Mr. Meyer" or the "debtor") received a cash bequest from his father's estate and paid the balances on two mortgage notes which he owed jointly with his wife. On June 13, 1995, Mr. Meyer filed a voluntary Chapter 7 petition; and, pursuant to 11 U.S.C. § 522(B)(2)(b), Mr. Meyer claimed, as exempt from his bankruptcy estate, the residential real property which he and his wife owned as tenants by the entirety. The appointed Chapter 7 Trustee, Harry Shaia, Jr., objected to the putative exemption of the real property and filed an adversary complaint on January 5, 1996, against Mr. Meyer and his wife, appellant Naomi A. Meyer.

The Trustee's complaint sought to avoid the mortgage payments as a state law voluntary conveyance under Va. Code § 55-81 and as a fraudulent conveyance under Va. Code § 55-80. The Bankruptcy Court conducted a trial on the merits of the Trustee's claims; and, on March 24, 1997, the Bankruptcy Court issued a Memorandum Opinion which held in favor of the Trustee and set aside the challenged transfers.

The Bankruptcy Court held that Meyer, instead of conveying an individual asset to a tenancy by the entirety of which he was a part, used his individual funds to satisfy a lien on behalf of the tenancy. As the Bankruptcy Court put it: "[i]n other words, by paying each mortgage note, the debtor transformed the cash bequest owned solely by him into equity in real

property held by both his wife and himself as tenants by the entirety." Accordingly, the "property passed from one legal entity (the debtor) to another (the debtor and his wife as tenants by the entirety)." Thereupon, the Bankruptcy Court concluded that "the courts of Virginia would deem the debtor's payment of each note as effecting one "transfer" under § 55-81 to the respective bank and a second "transfer" under § 55-81 to the tenancy by the entirety.

As a consequence, the Bankruptcy Court entered a joint and several judgment in the amount of $168,211.65 against Mr. and Mrs. Meyer, plus pre-judgment interest at the rate of 9% from February 28, 1994. The Bankruptcy Court also imposed an equitable lien on the real property to secure payment of the judgment. This appeal followed pursuant to 28 U.S.C. § 158(a).

BACKGROUND

The factual summary comes from the findings of fact as set forth in the Bankruptcy Court's Memorandum Opinion. See Catron v. Catron, 164 B.R. 912, 915 (E.D. Va. 1994) (the district court, on appeal, should adopt findings of fact made by the Bankruptcy Court unless there is clear error).

In 1973, Mr. and Mrs. Arnold Meyer purchased their residence as tenants by the entireties, and the real estate was held continuously thereafter in that mode of joint ownership. In August 1992, Mr. and Mrs. Meyer executed a promissory note for $163,750 in favor of Ryland Mortgage Company and provided, as security for that note, a first deed of trust on their residence. One day later, Mr. and Mrs. Meyer

executed a second note for $8,602.31 in favor of NationsBanc Home Equity Corporation of Virginia and provided, as security for that note, a second deed of trust of the same property.

The Meyers borrowed the funds from Ryland and NationsBanc in August 1992 to repay loans in the total face amount of $90,000 made in 1989 by Michael and Jennifer Fine to Mr. Meyer as operating capital for Busy Beaver of Virginia, Mr. Meyer's business. The loans were evidenced by notes dated: (i) September 14, 1989 in the amount of $10,000.00; (ii) October 9, 1989 in the amount of $20,000.00; and (iii) December 7, 1989 in the amount of $60,000.00. By February 28, 1994, Mr. Meyer owed the Fines a total of $110,833.27. In addition, by February 28, 1994, two civil judgments had been entered against Mr. Meyer in the amounts of $7,362.31 and $1,492.62, plus interest and costs, respectively.

In September 1993, Mr. Meyer's father died testate, and, under his father's will, Mr. Meyer was to receive one cash bequest of $10,000 and another cash bequest equal to the sum of any amounts owed by Mr. Meyer on his personal residence. Also, Mr. Meyer was devised a contingent interest in income from a family trust created by his father's will. That income, however, would not be dispersed to Mr. Meyer, however, during his mother's lifetime, and Mr. Meyer's contingent interest terminated if he predeceased his mother.

The cash bequests, totaling $169,223.71, were paid to Mr. Meyer; and, on February 24, 1994, he deposited a check from his father's estate totaling $169,223.71 into a joint checking account maintained by him and his wife. Mr. Meyer then pre-paid the

balances of the mortgage notes to Ryland and NationsBank which he and his wife owed on their residential real estate. At the time of the February 24 payment, the mortgage notes had not been called and were not in default. However, as of February 24, Mr. Meyer had defaulted on the Fine notes, in the amount of $110,833.27, and the two civil judgments remained unsatisfied. Mr. Meyer also was in arrears to other creditors.

During the ensuing year, Mr. Meyer continued to struggle financially. Finally, on June 13, 1995, Mr. Meyer filed a Chapter 7 petition for bankruptcy. Pursuant to 11 U.S.C. § 522(b)(2)(B), Mr. Meyer claimed his residential real property, held as tenants by the entireties with his wife, as exempt from his bankruptcy estate. He also claimed, as exempt, the contingent interest in the trust created by his father's will, as well as miscellaneous personal property.

STANDARD OF REVIEW

The Bankruptcy Court's findings of fact are subject to review for clear error. See Fed. R. Bankr. Proc. 8013; Catron v. Catron, 164 B.R. 912, 915 (E.D. Va. 1994); In re Broyles, 55 F.3d 980, 983 (4th Cir. 1995). "A finding of fact is clearly erroneous only when the reviewing court 'is left with the definite and firm conviction that a mistake has been committed.'" Broyles, 55 F.3d at 983 (quoting Anderson v. Bessemer City, 470 U.S. 564, 573 (1985). The Bankruptcy court's conclusions of law are reviewed *de novo*, however. See Khozai v. Resolution Trust Corp., 177 B.R. 524, 526 (E.D. Va. 1995); In re Superior Siding & Windor, Inc., 14 F.3d 240, 242 (4th Cir. 1994).

DISCUSSION

On appeal, Mr. Meyer argues first that the Bankruptcy Court was without authority to determine state law in the absence of a ruling from the state's highest court. He then advances several contentions respecting whether the Trustee met his burden of proving that there was a voluntary transfer which is voidable under Virginia law. Finally, Mr. Meyer contends that the Bankruptcy Court erred by granting an *in personam* money judgment against the defendants jointly and severally, and by awarding pre-judgment interest in its award.

A. Federal Court Authority to Decide State Law

The Bankruptcy Code provides that a trustee in bankruptcy "may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim . . . . 11 U.S.C. § 544(b). The applicable state law in this case was that of Virginia. Va. Code § 55-81 provides, in pertinent part, that: "[e]very gift, conveyance, assignment, transfer or charge which is not upon consideration deemed valuable in law . . . by an insolvent transferor, or by a transferor who is thereby rendered insolvent, shall be void as to creditors whose debts shall have been contracted at the time it was made . . . ."

The Supreme Court of Virginia has not decided whether a transfer occurs when an individual uses non-exempt funds to pre-pay a jointly owed debt which is secured by exempt property held as tenants by the entireties. In such circumstances, however, "it

has from the first been deemed to be the duty of the federal courts, if their jurisdiction is properly invoked, to decide questions of state law whenever necessary to the rendition of a judgment." Meredith v. City of Winter Haven, 320 U.S. 228, 233 (1943); see also Powell v. United States Fidelity & Guar. Co., 855 F. Supp. 858, 861 (E.D. Va. 1994), *aff'd*, 88 F.3d 271 (4th Cir. 1996); accord Martin v. State Farm Mut. Auto. Ins. Co., 375 F.2d 720, 722 (4th Cir. 1967) (holding that a federal court need not abstain from deciding uncertain questions of state law; the effect of such abstention would be to give defendant power to limit federal court jurisdiction). Thus, it seems rather clear that the Bankruptcy Court was entitled, indeed obligated, to ascertain by prediction the applicable state law.

Mr. Meyer, however, argues that the Bankruptcy Court could not follow that course and, instead, was confined to the application of the factors listed in Liberty Mutual Ins. Co. v. Triangle Industries, Inc., 957 F.2d 1153, 1156 (4th Cir. 1992). In Mr. Meyer's view, the Bankruptcy Court erred because it strayed from that list. It is correct that, in Liberty Mutual, the Fourth Circuit explicitly stated that federal courts could "consider, among other things, canons of construction, restatements of the law . . . ." Liberty Mutual, 957 F.2d at 1156 (emphasis added).

Mr. Meyer correctly states that the Bankruptcy Court looked to Virginia state law decisions, to the Bankruptcy Code, and to other federal decisions in predicting state law. In so doing, the Bankruptcy Court did not run afoul of the holding in Liberty Mutual. To the contrary, a reasonable interpretation of the phrase "among other things," as articulated in Liberty Mutual, would include the jurisprudential

sources considered by the Bankruptcy Court. Indeed, the text of Liberty Mutual makes clear that the factors there mentioned are not exclusive.

Moreover, there is no valid reason why a Bankruptcy Court should be artificially restricted in an effort to ascertain state law. So long as the Bankruptcy Court explains how it arrived at its prediction and stayed within appropriate analytical constraints, it should not be faulted for making an effort to determine whether state law includes accepted principles found in other jurisdprudential sources. Here, the Bankruptcy Court fulfilled both requisites. The Bankruptcy Court, therefore, did not err in its approach to predicting state law.

B. Voluntary Transfer

Mr. Meyer next contends that the transfer at issue was not a voidable voluntary transfer under Virginia law. To qualify as such a transfer, it must be shown that: (1) there was a transfer in fact; (2) there was consideration deemed valuable in law; and (3) the transfer rendered Mr. Meyer insolvent. After a complete evidentiary hearing, the Bankruptcy Court held that two transfers occurred when the debtor pre-paid his mortgage notes. The only "transfer" in dispute, however, is the second one which transpired between Mr. Meyer, on the one hand, and Mr. Meyer and his wife, on the other.

1. Was There a Transfer?

Several basic principles inform the analysis which applies here. First, in Valley Acceptance Corp. v. Glasby, 337 S.E.2d 291, 295 (Va. 1985), the

Supreme Court of Virginia held "as an inflexible rule that the mere form [of a transaction] is immaterial, but that it is the substance which must be considered." Second, the Supreme Court of Virginia has applied that rule to decide issues of involuntary transfer. For example, in Cramer v. Senger & Turner, 59 S.E. 375, 377 (Va. 1907), the Supreme Court considered a transfer of real estate by the estate of the debtor's father-in-law to the debtor's wife as consideration for an antecedent debt owed by the father-in-law to the debtor. Ignoring the form of the transfer, the Court held that the conveyance had been from the estate to the debtor who then had conveyed to the wife. In so doing, the Court explained that "the consideration for the conveyance to Catherine Cramer moved from A. Cramer, and not from herself; in other words, that the land having been conveyed to Catherine Cramer at the request of her husband, A. Cramer, it was nothing more than a gift from him, and void as to his creditors." Id.

The Bankruptcy Court also found instructive the decision in In re Porter, 37 B.R. 56 (Bankr. E.D. Va. 1984) wherein the court held that "a debtor may not transfer assets to another party in order to gain the exempt status." Id. at 69 (citing In Re White, 28 B.R. 240, 243 (Bankr. E.D. Va. 1983)). In deciding Porter, the Bankruptcy Court explained that its decision in White had discussed why a transfer of real property from one individual to that individual and his wife as tenants by the entirety was not a simple act of converting nonexempt assets to exempt assets. Porter, 37 B.R. at 69.

In White, the debtor had conveyed to himself and his wife as tenants by the entireties real property which the debtor had owned individually. At the time

of that transfer, the debtor had an existing creditor. Shortly thereafter, the debtor filed a petition in bankruptcy and claimed the jointly owned real property as exempt pursuant to 11 U.S.C. § 522(b)(2)(B). The Bankruptcy Court held that the debtor had engaged in a two party transfer in which the debtor had attempted unsuccessfully to transform non-exempt property into exempt property by transferring an interest in that property to another person. White, 28 B.R. at 243. As the court explained: "[d]ebtors may not shield their assets by transferring them to family members or other persons." Id. With that principle in mind, the court examined the nature and purpose of the transfer and concluded that the debtor had attempted to exempt his property by conveying part interest to his wife instead of retaining an entire interest in the property in an effort to convert it into exempt property. Finding that the debtor had engaged in the transaction in an effort to immunize it from the claims of his chief judgment creditor, the court held that the transfer was voidable. Id.

Likewise Mr. Meyer impermissibly altered the ownership rights in the cash bequest which he received from his father's estate when he used it to pre-pay mortgages which he and his wife owned jointly. In so doing, Mr. Meyer attempted to transfer the cash bequest – his individual, non-exempt asset – from himself to himself and his wife as tenants by the entireties. The transfer of cash bequest, therefore, resulted in a corresponding increase in the equity in the exempt, real property.

Considering the rather fundamental teaching of Cramer and the decisions in Porter and White, it cannot be said the Bankruptcy Court erred in finding

that a transfer occurred and that the transaction should be voided to prevent the creditors from being prejudiced by Mr. Meyer's effort to convert the non-exempt cash bequest into an exempt asset.

2. Was There Consideration?

Next, Mr. Meyer contends that there was consideration to support the transfer. Specifically, it is his assertion that the increase in equity in the real property (which ensued solely as a result of the payment of the mortgages by the proceeds of the cash bequest) was consideration for the second transfer. This argument, however, only addresses half of the equation. It is clear that Mr. and Mrs. Meyer, as tenants by the entirety, enjoyed the benefit of increased equity in the real property as a result of the mortgage payments. However, Mr. Meyer failed to demonstrate what, if any, detriment he and his wife, as tenants by the entirety, incurred as a result of these payments. The most obvious reason is that there was no detriment.

Moreover, this argument would turn the voidable voluntary transfer statute on its head. The purpose of Section 55-81 is to avoid otherwise valid transactions under the principle that a debtor must be just before he is generous to his family and friends. See Battle v. Rock, 144 Va. 1, 131 S.E. 344 (1926). Mr. Meyer's cash payments, therefore, must be considered to be gifts to himself and his wife as tenants by the entirety. The Bankruptcy Court was correct in finding that there was no consideration.[1]

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[1] The issue of adequacy of consideration is therefore moot.

3. Did the Transfer Result in Insolvency?

Finally, in order for the Bankruptcy Court to have found that a voidable voluntary transfer occurred, the Trustee had to prove that Mr. Meyer was either insolvent at the time of the transfer or that the transfer rendered Mr. Meyer insolvent. Mr. Meyer asserts that Virginia law requires the use of a straight "balance sheet" definition of insolvency. Under that definition, according to Mr. Meyer, all of a person's assets, without exclusion, are measured against his total liabilities. When that is done, says the debtor, he was solvent at the time of transfer.

In deciding the insolvency issue, the Bankruptcy Court considered the expert testimony of an insolvency analyst and Virginia law. At trial, the expert testified that any assets which Mr. Meyer's creditors could not reach were meaningless in assessing solvency. Under that approach, if the assets could not be used to satisfy Mr. Meyer's debts, they could not be included in the insolvency analysis. Mr. Meyer did not proffer any authority or expert testimony to contradict this evidence. Therefore, the Bankruptcy Court was not in error when it accepted the expert's testimony on the point.

Moreover, that approach is supported by the decision in Hudson v. Hudson, 249 Va. 335, 341, 455 S.E.2d 14, 20 (1995), wherein the Supreme Court of Virginia held that the proper evaluation of the debtor's assets following a transfer necessarily excluded the value of the transferred property itself. Here, the equity which resulted from the pre-payment of the mortgage notes was the transferred property. If the Bankruptcy Court had included this in the insolvency analysis, the debtor would have received the benefit of

including an asset which his creditor's could not reach. The decision in Hudson and the expert testimony adequately support the Bankruptcy Court's finding that the increased equity in the home (owned as tenants in the entirety) which occurred as a result of the challenged transfer could not be included in the insolvency analysis.

Mr. Meyer also argues that the Bankruptcy Court erred when it excluded his exempt assets from the insolvency calculus. Here too, he is in error.

Under Virginia law, insolvency is viewed from the perspective of a debtor's creditors. See Gray v. McCormick, 181 Va., 52, 62, 23 S.E.2d 803, 807-808 (1943). The nature of exempt property is that creditors cannot seize it and cannot liquidate it. For example, the homestead exemption protects debtors from destitution by allowing them to retain stakeholds. See In re Latham, 182 B.R. 479, 481 (Bankr. W.D. Va. 1995); In Re Smith, 22 B.R. 866, 867 (Bankr. E.D. Va. 1982); see also Barker v. Jenkins, 84 Va. 895, 6. S.E. 459 (1888). Exemption statutes reflect a legislative purpose "to protect the exempt property from all manner of coercive process of the law, and not merely to protect the earnings of the debtor and other exempt property from seizure by means of the processes technically known as attachment, execution or garnishment . . . ." Atlantic Life Insurance Co. v. Ring, 167 Va. 121, 127, 187 S.E. 449, 451-52 (1936). Consequently, exempt property is not countable as assets for purposes of determining solvency. See In Re Babiker, 180 B.R. 458, 461 (Bnkr. E.D. Va. 1995) (where the debtors had claimed their exemptions pursuant to Virginia law, the creditor cannot include the exempt property as assets).

Here, Mr. Meyer wishes to use statutorily given exemptions to avoid paying his creditors, but, at the same time, he deserves to include the value of the exempt property as an asset for purposes of solvency calculation. These concepts are mutually exclusive.

Moreover, Mr. Meyer's argument is at odds with the better reasoned decisions on the issue. Many of those decisions are decided under the Uniform Fraudulent Transfer Act (UFTA). Although Virginia has not adopted the UFTA in its entirety, Section 55-81 now parallels Section 5 of the UFTA.[2] Courts interpreting UFTA's definition of solvency have found that assets do not include property to the extent that is generally exempt under non-bankruptcy law. See First Nat. Bank v. Frescoln Farms, Ltd., 430 N.W.2d 432, 436-37 (Iowa 1988); In re Kantz, 97 B.R. 514, 523 (Bankr. N.D. Iowa 1989). The rationale for this rule is found in the rather obvious proposition that "[s]olvency that is based on exempt property is no

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[2] Section 55-81 [provides in pertinent part:

Every gift, conveyance, assignment, transfer or charge which is not upon consideration deemed valuable in law, or which is upon consideration deemed valuable in law, or which is upon consideration of marriage, by an insolvent transferor, or by a transferor who is thereby rendered insolvent, shall be void as to creditors whose debts shall have purchased after it was made.

Section 5(a) of the UFTA provides in pertinent part:

A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the *debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.*" (emphasis added).

better than insolvency to a creditor because the property is not available without affirmative action by the debtor . . . . If a creditor cannot reach the property through some sort of legal process, we hold that the property cannot be used to show solvency." Frescoln Farms, 430 N.W.2d at 436 (citing 37 C.J.S. Fraudulent Conveyances § 105, at 945).

In this context, the Bankruptcy Court concluded that a general legal consensus operates to exclude exempt property from the debtor's assets; and the Bankruptcy Court was persuaded that the same reasoning would be embraced by Virginia courts. For the reasons given by the Bankruptcy Court, its decision on that issue is affirmed.

Mr. Meyer finally argues that his contingent interest in a family trust should have been valued as an asset, and that, if that had been done, the transfer would not have rendered him insolvent. The decision in Howbert v. Cawthorn, 100 Va. 649, 42 S.E. 683 (1902), however, makes clear that creditors cannot attach a contingent remainder. See also In re Camden, 217 F. Supp. 634, 638 (W.D. Va. 1963) (citing Howbert.) In Howbert, a grantor conveyed real property in trust for his wife's use , with a remainder in fee simple to those children who survived her. The Supreme court of Virginia explained that "such a unsubstantial and shadowy right . . . is a pure contingency, a bare possibility whether it will ever exist or not." Id. at 686. to himself and his wife as tenants by the entireties Because Howbert holds that an interest of that ilk cannot be reached by a debtor's creditors, the Bankruptcy Court was correct in excluding the contingent remainder interest from its solvency calculations.

Even if the Bankruptcy Court had included the debtor's contingent remainder interest in the family trust in the insolvency calculation, Mr. Meyer nonetheless would have been insolvent at the time of transfer because the contingent remainder interest was given a hypothetical value of only $34,000.00 and that sum would not have made Mr. Meyer solvent.[3]

For the foregoing reasons, the finding of the Bankruptcy Court that Mr. Meyer was rendered insolvent when he made the transfer is affirmed.

C. The Remedy Ordered by the Bankruptcy Court

Having determined that a voidable voluntary transfer had occurred, the Bankruptcy Court turned to Section 550(a) of the Bankruptcy Code for a remedy, 11 U.S.C. § 550(a). This section provides that, "to the extent that a transfer is avoided under section 544 . . ., the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property . . . from the initial transferee . . . ." Section 550(a) is intended to restore the estate to the financial condition it would have enjoyed if the transfer had not occurred. See In

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[3] The Bankruptcy Court's Finding of Facts reveal that the total amount of Mr. Meyer's liabilities was $201,922.00 as of February 28, 1994. The total amount of Mr. Meyer's assets, excluding the value of the property, the funds used to make the Mortgage pre-payments and one-half of the value of the assets owned jointly by Mr. Meyer and his wife, was $60,414.00. This leaves a shortfall of $141,508.00. Therefore, even if Mr. Meyer's contingent remainder interest were included, this would only decrease the shortfall to $107,508.00. Moreover, even if the value of Mr. Meyer's one-half interest in the property ($175,000/2 = $87,500) were included in his solvency analysis, Mr. Meyer would have a negative net worth of $20,008.00.

re American Furniture Outlet USA, 209 B.R. 49, 51-52 (Bankr. M.D.N.C. 1997); In re Aero-Fastener, Inc., 177 B.R. 120, 139 (Bankr. D. Mass. 1994); In re Classic Drywall, Inc., 127 B.R. 874, 876 (Bankr. D. Kansas 1991).

It is within the Bankruptcy Court's discretion to determine whether to order payment of the value of the property or to order return of the property. See Aero-Fastner, 177 B.R. at 139. Here, the initial transferee was the tenancy by the entirety, comprised of property owned by Mr. and Mrs. Meyer. Because money was the transferred property, the Trustee can recover from the tenancy by the entirety the money transferred to it.

Mr. Meyer argues that this remedy is not available because imposing it operates to deprive him of exemptions to which he is entitled by statute. He also contends that the Bankruptcy Court exceeded its authority by awarding an *in personam* judgment, jointly and severally, against him and his wife. These arguments miss the point. Mr. Meyer effectuated a transfer which is voidable under Virginia law because it was wrongful. Section 550 of the Bankruptcy Code gives the Trustee the right to recapture impermissibly transferred property. Here, because the transferred property is money, the only way for the Trustee to recover the transferred property is to receive a money judgment in the amount of the transferred asset and, thereafter, to enforce the judgment by selling the real estate, the equity of which was enhanced by the voidable transfer. That, of course, merely restores the bankrupt estate to the financial condition in which it would have been if Mr. Meyer's transfer had not occurred.

The remedy selected by the Bankruptcy Court is further supported by the decision in Price v. Hawkins, 247 Va. 32, 439 S.E.2d 382 (1994). There, the Supreme Court of Virginia upheld the entry of *in personam* judgments as a means to recover property which was the subject of an avoided voluntary transfer of assets. It also is well established that a federal court can afford equitable relief which is not available in state court. See Guaranty Trust Co. v. York, 326 U.S. 99, 105 (1945). The Bankruptcy Court, therefore, did not err in ordering a joint and several judgment against Mr. and Mrs. Meyer.

Finally, Mr. Meyer asserts that the Bankruptcy Court was not permitted to award pre-judgment interest. Under Va. Code § 8.01-382, the award of pre-judgment interest is within the discretion of the court. Matters within the discretion of the Bankruptcy Court should not be set aside a on appeal unless there was an abuse of that discretion. See In re Jackson, 190 B.R. 808, 810 (W.D. Va. 1995). The statutory rate of interest pursuant to Va. Code § 6.1-330.54 is nine percent (9%) per annum.

Here, the Bankruptcy Court did consider whether a compelling reason not to award interest was present and found none. This Court agrees. The Bankruptcy Court was correct in awarding prejudgment interest at the rate of 9% per annum beginning February 28, 1994.

For the foregoing reasons, the judgment of the Bankruptcy Court is hereby affirmed.

The Clerk is directed to send a copy of this Memorandum Opinion to all counsel of record.

It is so ORDERED.

/s/ Robert E. Payne
United States District Judge

Richmond, Virginia
Date: March 12, 1998

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA

Richmond Division

In re: ARNOLD MEYER

Debtor.

ARNOLD I. MEYER
NAOMI A. MEYER

Appellants,

v. Civil Action No. 3:97cv352

HARRY SHAIA, JR.,

Trustee- Appellee.

ORDER

For the reasons set forth in the accompanying Memorandum Opinion, it is hereby ORDERED that the judgment of the Bankruptcy Court is affirmed.

The Clerk is directed to send a copy of this Order to all counsel of record.

It is so ORDERED.

/s/ Robert E. Payne
United States District Judge

Richmond, Virginia
Date: March 12, 1998

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

In re: ARNOLD I. MEYER	)	Civil Action No.
	)	3:97cv352
	)	
Debtor.	)	
	)	
HARRY SHAIA, JR., TRUSTEE,	)	In the United States
	)	Bankruptcy Court
	)	
Plaintiff,	)	Case No. 95-32427-T
	)	Chapter 7
v.	)	
	)	Adv. Proc. No.
ARNOLD I. MEYER	)	96-3006-T
NAOMI A. MEYER,	)	
	)	
Defendants.	)	

ORDER

On motion by Harry Shaia, Jr., Trustee-Appellee, requesting that the Court make technical corrections in two areas of the Memorandum Opinion entered March 12, 1989, pursuant to Rule 60 of the Federal Rules of Civil Procedure, and deeming it otherwise right and proper so to do, it is accordingly

ADJUDGED, ORDERED and DECREED as follows:

1. That page 4 of the Memorandum Opinion is CORRECTED so that the first two sentences of the second paragraph on page 4 are DELETED and the following sentences are INSERTED:

> In 1989, Arnold I. Meyer had also borrowed funds in the total face amount of $90,000 from Michael and Jennifer Fines as operating capital for Busy Beaver of Virginia, Mr. Meyer's business. These loans were evidenced by notes dated: (i) September 14, 1989 in the amount of $10,000.00; (ii) October 9, 1989 in the amount of $20,000.00; and (iii) December 7, 1989 in the amount of $60,000.00.

and

2. That on page 19 of the Memorandum Opinion, the following sentence fragment is DELETED from Page 19 of the Memorandum Opinion: "to himself and his wife as tenants by the entireties."

Let the Clerk send a copy of this Order to all counsel or parties of record.

ENTER: March 30, 1998

/s/ Robert E. Payne
United States District Judge

I ask for this:

/s/ James J. Burns

James J. Burns – VSB No. 19021
Patrick R. Hanes – VSB No. 38148
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Trustee-Appellee

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

IN RE ARNOLD I. MEYER Case No. 95-32427-T

Debtor Chapter 7

HARRY SHAIA, JR., TRUSTEE
Plaintiff

v.
Adv. Proc. No. 96-3006-T

ARNOLD I. MEYER and
NAOMI A. MEYER
Defendants

MEMORANDUM OPINION

Prior to filing his bankruptcy petition, the debtor received a cash bequest from his late father's estate. Although the will did not require him to do so, the debtor used the funds to pay off two mortgages which encumbered a parcel of residential real property held by him and his wife as tenants by the entirety. In this adversary proceeding, the Chapter 7 trustee asserts that those payments constituted a voluntary or fraudulent conveyance which can be recovered by the bankruptcy estate. On November 14, 1996, the court held a trial on the trustee's complaint and then took the ruling under advisement. For the reasons set forth in this memorandum opinion, judgment will be entered in favor of the trustee.

Findings of Fact

On October 1, 1973, the Meyers acquired a parcel of improved real property in Henrico County, Virginia, as tenants by the entirety with a right of survivorship. Although the property had been encumbered and refinanced several times over the years, the interests at issue in this case arose less than five years ago. Specifically, on August 3, 1992, the Meyers executed a promissory note for $163,750.00 in favor of Ryland Mortgage Company[1] and provided as security a first deed of trust on the property. One day later, they executed a second note for $8,602.31 in favor of NationsBanc Home Equity Corporation of Virginia, providing as security a second deed of trust on the property.

The Meyers incurred these debts to pay off a prior lender who had funded the debtor's business, a corporation named Wispy of Southern Virginia, Inc., which later traded as Busy Beaver of Virginia. Through that corporation, formed in February 1987, the debtor offered a wide array of consumer home repair services, from window replacement to the installment of aluminum siding. By 1993, however, Busy Beaver had become insolvent and had ceased doing business as an ongoing concern. As a consequence, the debtor was forced to continue accepting gifts from his family and to obtain regular cash advances from his credit cards in order to make ends meet.

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[1] Some time later, Ryland assigned the note to Texas Commerce Bank National Association.

On September 12, 1993, the debtor's father died testate. Under the will, the debtor received one cash bequest in the amount of $10,000.00 and another equal to the outstanding balances on all mortgages encumbering his personal residence. In addition, the will created two trusts with a corpus totaling $1.25 million. The debtor, however, had no right to the income earned by these trusts during his mother's lifetime and would lose any claim to the corpus if he predeceased her.

In two letters mailed in November 1993, the co-executor of the estate reminded the debtor that, although the will referred to the mortgage notes in fixing the amount of the second cash bequest, he was not required to pay any money to Texas Commerce and NationsBanc. Nevertheless, the debtor believed that his father wanted him to own his residence free and clear of any liens and that he therefore had a "moral duty" to pay off the notes. On February 24, 1994, the debtor deposited a check from the estate totaling $169,223.71 into a joint checking account maintained with his wife. He then paid NationsBanc $6,183.75 on February 27, 1994, and Texas Commerce Bank $162,027.90 on February 28, 1994, in full satisfaction of their claims.

At the time the debtor prepaid the mortgage notes, they had not been called. The debtor, however, had defaulted in his repayment to several unsecured creditors.

- Needing operating capital for Busy Beaver, the debtor in 1989 had borrowed

$90,000.00 from Michael and Jennifer Fine and had executed demand notes in their favor. Though the

Fines had called the notes, the debtor still owed them $110,833.27 on February 28, 1994.

- On October 5, 1992, the Rusco Window Company had obtained a civil judgment

against the debtor for $7,362.31 plus interest and costs. This judgment remained unsatisfied on February 28, 1994.

- On March 8, 1993, the Ted Lansing Corporation had obtained a civil judgment

against the debtor for $1,492.62 plus interest and costs. This judgment too remained unsatisfied on February 28, 1994.

These debts, together with those held by other unsecured creditors, had contributed significantly to the debtor's financial woes by the time he received the bequest. Excluding the value of his interest in the real property,[2] the debtor's assets had a value of $60,414.00 on February 28, 1994. (Ex. A to Trustee's Proposed Findings of Fact and Conclusions of Law.) On that same date, excluding any amount due under the mortgage notes, the debtor had liabilities totaling $201,922.00. (Ex. A to Trustee's Proposed Findings of Fact and Conclusions of Law.)

During the following year, the debtor continued to be pressed by his creditors. For instance, when the Ted Lansing Corporation filed a summons to garnish the debtor's wages on January 20, 1995, the debtor was forced to settle the claim and to pay $2,100.00 in full satisfaction of the judgment. Finally, after

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[2] The parties have agreed that the fair market value of the real property is $175,000.00.

consulting with friends and an attorney, the debtor filed a petition under Chapter 7, of the Bankruptcy Code on June 13, 1993. In his schedule of property claimed to be exempt from the bankruptcy estate pursuant to 11 U.S.C. § 522(b)(2)(B), the debtor included the residential real property still held with his wife as tenants by the entirety, his contingent interest in the trust created by his father's will, and miscellaneous personal property totaling $10,150.00.

Trustee's Complaint

The trustee filed a complaint against the debtor and his wife on January 5, 1996, which asserted that the "transfer" of the debtor's individual non-exempt cash bequest into an exempt interest in the residential real property constituted both a voluntary conveyance under Va. Code § 55-81 and a fraudulent conveyance under Va. Code § 55-80. The trustee therefore asked the court (1) to award a joint and several judgment against the Meyers for the amount of the "transfer," (2) to find that the trustee can satisfy the judgment by selling the real property, (3) to determine the validity, priority, and extent of interests in and liens on the property, and (4) to approve a sale of the property by the trustee pursuant to 11 U.S.C. § 363(h).

Discussion and Conclusions of Law

This case presents the novel issue of whether a trustee in bankruptcy can set aside a pre-petition payment made by the debtor, in his individual capacity and with non-exempt funds, on a debt owned jointly by him and his wife and secured by exempt realty which they hold as tenants by the entirety. The court has been unable to find a case directly on point.

The Voluntary Conveyance

The Bankruptcy Code provides that a trustee in bankruptcy "may avoid any interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an [allowable] unsecured claim . . . ." 11 U.S.C. § 544(b). The parties agree that the "applicable law" in this proceeding is that of Virginia, the state in which the events detailed above took place.

Section 55-81 of the Virginia Code provides, in pertinent part, that "[e]very gift, conveyance, assignment, transfer or charge which is not upon consideration deemed valuable in law . . . by an insolvent transferor, or by a transferor who is thereby rendered insolvent, shall be void as to creditors whose debts shall have been contracted at the time it was made . . . ." Therefore, in order for the trustee to prove that a voluntary conveyance has been made under Virginia law, he must prove (1) a transfer made by the debtor (2) for consideration not deemed valuable in law (3) while the debtor was insolvent or by which he was rendered insolvent.

A.

The trustee contends that the conversion of the non-exempt cash bequest into equity in exempt entireties property constitutes a "transfer" under Va. Code § 55-81. To this end, the trustee alleges that, when the debtor paid off each mortgage note, he made two distinct transfers: one to the bank and one to

himself and his wife as tenants by the entirety.[3] The Meyers have responded that only a single transfer occurred -- the payment of each mortgage note to the bank -- and that, in any event, the conversion of non-exempt assets to exempt property does not constitute a "transfer."

Virginia law is silent on these questions. Nevertheless, this court must stand in the shoes of the Virginia judiciary and resolve the issues as a state court most probably would. Powell v. United States Fidelity & Guar. Co., 855 F. Supp. 858, 861 (E.D. Va. 1994), aff'd, 88 F.3d 271 (4th Cir. 1996). Fortunately, bankruptcy law addresses fraudulent and voluntary conveyances in some depth, and I believe that the Virginia courts would find its approach to the matters raised in this proceeding persuasive.

The Bankruptcy Code defines "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . ." 11 U.S.C. § 101(54). This term has been construed broadly, and even where a reading may possess some "technical validity," form has not been elevated over substance. Smith v. Moody (In re Moody), 77 B.R. 566, 572 (Bankr. S.D. Tex. 1987), aff'd, 862 F.2d 1194 (5th Cir. 1989), cert. denied, 503 U.S. 690 (1992); see also Tonyan Constr. Co. v. McHenry State Bank (In re Tonyan Constr. Co.), 28 B.R. 714, 728-29 (Bankr. N.D. Ill. 1983); see generally Pepper v. Litton, 308 U.S. 295, 304-05 (1939) (reaffirming that bankruptcy courts should invoke

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[3] The Trustee has elected not to avoid the "first transfer" to the banks, since the bankruptcy estate would be burdened by an equal amount of new debt.

their equitable powers in order to ensure that "substance will not give way to form"); Brockington v. Scott, 381 F.2d 792, 794 (4th Cir. 1967). In particular, bankruptcy courts in this district have acknowledged that a single transfer of funds can effect two separate "transfers" under the Code. See, e.g., In re Wilkinson, 196 B.R. 311, 319 (Bankr. E.D. Va. 1996).

Similarly, the Virginia Supreme Court has laid down "as an inflexible rule that the mere form [of a transaction] is immaterial, but that it is the substance which must be considered." Valley Acceptance Corp. v. Glasby, 337 S.E.2d 291, 295 (Va. 1985) (quoting Van Dyke v. Commonwealth, 17 S.E.2d 366, 369 (Va. 1941)). For instance, in Cramer v. Senger & Tumer, 59 S.E. 375 (Va. 1907), the estate of the debtor's father-in-law agreed to convey real property to the debtor as consideration for an antecedent debt. With a judgment creditor ready to attach any property coming into his possession, however, the debtor requested that the estate transfer the property to his wife. The supreme court held that, notwithstanding the form of the transfer, this property effectively had been conveyed to the debtor and then from him to his wife as a gift. Id. at 377. As a result, the court held that the property in the hands of his wife remained subject to the claims of the debtor's creditors.

This decision in Cramer, together with the broad definition of "transfer" adopted by the Bankruptcy Code, persuades the court that Virginia law would embrace a liberal reading of "transfer" and that the payment of each mortgage note by the debtor *could* have effected the two separate transfers described by the trustee. The question which remains, then, is whether the debtor's use of the cash

bequest *did in fact* cause the second alleged transfer. In other words, would the judiciary in Virginia actually characterize the debtor's conversion of non-exempt assets into exempt property as a "transfer" under § 55-81?

This court finds the decision in Hyman v. Porter (In re Porter), 37 B.R. 56 (Bankr. E.D. Va. 1984), instructive. In Porter, after the debtor had been found liable in state court on an indemnity agreement, he transferred real property to both his wife and himself as tenants by the entirety. The bankruptcy court felt "obliged to address the debtor's contention that the transfer . . . was a permissible act of converting nonexempt to exempt assets." Id. at 69. While acknowledging that the Code permits such a conversion even on the eve of bankruptcy, the court observed that "transferring real property from one individual to that individual and his wife as tenants by the entirety is not a simple act of converting nonexempt to exempt assets . . . ." Id. "Transferring real property from one individual to an individual and his wife is a transfer of property, it is not a mere conversion; the ownership rights are materially altered by the transfer." Id.; see also Schmidt v. White (In re White), 28 B.R. 240, 243 (Bankr. E.D. Va. 1983) (holding that "it is clear that this is a two party transfer").

Keeping in mind the equitable principle of "substance over form," this court can find no basis for distinguishing the facts here from those in Porter. Put simply, the debtor in this case did indirectly what his counterpart in Porter did directly. Instead of conveying an individual asset to a tenancy by the entirety of which he was a part, the debtor used his individual funds to satisfy a lien on behalf of the

tenancy. In other words, by paying each mortgage note, the debtor transformed the cash bequest owned solely by him into equity in real property held by both his wife and himself as tenants by the entirety. The substance of the transaction is the same -- property passed from one legal entity (the debtor) to another (the debtor and his wife as tenants by the entirety). This court therefore holds that the courts of Virginia would deem the debtor's payment of each note as effecting one "transfer" under § 55-81 to the respective bank and a second "transfer" under § 55-81 to the tenancy by the entirety.

B.

The second element of a voluntary conveyance requires that the transfer was made for consideration not deemed valuable in law. The Meyers contend that the debtor received adequate consideration for his payment of the notes when the banks released their liens on the real property. Although this may be reasonable consideration for the "first transfer" to each bank, the release has no bearing on the "second transfer." Since the trustee seeks to avoid only the latter, the court must focus on consideration which flowed to the debtor from the tenancy by the entirety, not from the banks.

Reviewing the evidence, the court can find none. While the "phrase 'consideration deemed valuable in law' refers to *any* valuable consideration received by the transferor," Moore v. Manson (In re Springfield Furniture, Inc.), 145 B.R. 520, 533 (Bankr. E.D. Va. 1992), the tenancy by the entirety incurred no tangible or intangible legal detriment in exchange for the debtor's payment on its behalf. The debtor simply made a gift to the tenancy in the form of the

satisfied mortgage notes. Having thus been unable to discern any consideration provided to the debtor from the tenancy, and certainly none which could be deemed "valuable" or "adequate" or "fair and reasonable," the court holds that the trustee has proven the second element of a voluntary conveyance under § 55-81 of the Virginia Code.

C.

Finally, the trustee must show either that the debtor made the second transfer while insolvent or that the transfer rendered him insolvent. A debtor will be deemed insolvent under § 55-81 "when he has insufficient property to pay all his debts." Hudson v. Hudson, 455 S.E.2d 14, 17 (Va. 1995). Since "both the value of the debtor's assets and the amount of his liabilities" must be shown in order to prove insolvency, id, the trustee at trial introduced expert testimony on the debtor's financial worth as of February 28, 1994, the first date by which both notes had been paid.

During their cross-examination of the trustee's expert, the Meyers challenged several aspects of the financial analysis. They first argued that the value of the resulting equity, or conversely the amount paid on the notes, should be included as an asset on the balance sheet. This position, however, overlooks the fact that § 55-81 includes as a voluntary conveyance any transfer that renders the debtor insolvent. When ascertaining whether a transfer has had such an effect, the court looks at the debtor's net worth *after* he parted with the property.[4] Including the property's

[4] The Virginia Supreme Court implicitly acknowledged this in Hudson: "Thus, Carole was required to establish that the amount of Forest's liabilities at the date of the transfer exceeded the

value in the solvency calculation, as the debtor would have the court do, would treat the debtor as still owning the property in his individual capacity and would reveal only whether the debtor was insolvent *before* he made the transfer.

The Meyers next objected to the expert's refusal to include the value of the debtor's exempt property as an asset. Since Virginia law does not address this question, the court once again must evaluate the positions adopted by other jurisdictions and decide which, if any, the Virginia courts most probably would follow. In this instance, a consensus appears to have formed around the approach which excludes exempt property from the debtor's assets. See First Nat'l Bank in Fairfield v. Fresoln Farms, Ltd., 430 N.W.2d 432, 436 (Iowa 1988) (finding this theory to be embodied in the common law, in the Uniform Fraudulent Conveyances Act, and in the more recent Uniform Fraudulent Transfer Act); Babiker v. Citizens Contracting Co. (In re Babiker), 180 B.R. 458, 461 (Bankr. E.D. Va. 1995) (noting that an identical position has been adopted in the Bankruptcy Code's definition of "insolvent" at 11 U.S.C. § 101(32)(A)).

The rationale for this widely accepted rule is that solvency "based on exempt property is no better than insolvency to a creditor because the property is not available without affirmative action by the debtor." Fresoln Farms, Ltd., 430 N.W.2d at 436. The court believes that this reasoning would be embraced by Virginia courts, particularly since the fraudulent and voluntary conveyance laws were enacted to protect creditors. See Battle v. Rock, 131 S.E. 344, 348 (Va.

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amount of his assets, *exclusive of the transferred real estate*, on the same date." Hudson, 455 S.E.2d at 17 (emphasis added).

1926) (stating that the "principle upon which voluntary conveyances are held void as to existing creditors is that a man should be just before he is generous"). Therefore, in the solvency analysis under § 55-81, the value of the debtor's exempt assets shall not be considered.

The Meyers final quarrel with the trustee's valuation expert centered on his decision to exclude the debtor's contingent interest in the two trusts created under his father's will. While the bankruptcy estate encompasses such an interest pursuant to 11 U.S.C. § 541, Banner v. Bagen (In re Bagen), 186 B.R. 824 (Bankr. S.D.N.Y. 1995), aff'd, 201 B.R. 642 (S.D.N.Y. 1996), it does not follow that the interest should be considered when ascertaining the debtor's solvency under Virginia law. As stated earlier, this court is convinced that the judiciary in Virginia would evaluate solvency from the perspective of the debtor's creditors. In other words, if an asset cannot be attached, then it will not be brought into the analysis. Therefore, the proper question here is whether the debtor's contingent interest can be levied upon by his creditors.

In Howbert v. Cawthorn, 42 S.E. 683 (Va. 1902), a grantor had conveyed real property in trust for the use of his wife, with a remainder in fee simple to those children who survived her. In evaluating the interest held by the children, the Virginia Supreme Court noted that "such an unsubstantial and shadowy right . . . is a pure contingency -- a bare possibility whether it will ever exist or not." Id. at 686. "[S]uch an interest hardly rises to the dignity of an estate," and "[o]n the part of a purchaser at a judicial sale, it would be a perfect hazard." Id. The supreme court concluded, therefore, that a contingent remainder

interest cannot be attached by creditors.[5] Similarly, in this proceeding, any interest which the debtor might claim in the two trusts will be contingent on him surviving his mother. Since Howbert holds that such an interest cannot be reached by his creditors, its value should be excluded from the solvency calculation under § 55-81 of the Virginia Code.

For these reasons, and with the Meyers having failed to proffer a contrary analysis, the court accepts the expert testimony introduced by the trustee in full. As a result, the court finds that the debtor had a negative net worth of $141,508.00 on February 28, 1994, and that the payment of $168,211.65 to the noteholders rendered the debtor insolvent under Virginia law.[6]

D.

In light of the foregoing discussion, the court concludes that the debtor made a transfer to the tenancy by the entirety for consideration not deemed

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[5] Only one change has been made to this rule since the supreme court's decision in Howbert. In 1977 the Virginia legislature enacted a provision which authorizes creditors to attach a contingent remainder if the principal defendant is a nonresident or an "absconding debtor." Va. Code § 8.01-547. Even so, the statute still does not permit the interest to be sold until after it has vested. Id.

[6] The evidence at trial demonstrated that, in calculating the $141,508.00 shortfall, the trustee's expert excluded from the debtor's assets the value of his undivided one-half interest in the real property ($87,500.00) and his contingent remainder in the two trusts ($34,000.00). Nevertheless, even if these two interests were included in the solvency calculation and the value of the his exempt personal property ($10,150.00) not deducted from his assets, the debtor's liabilities would still exceed his assets by more than $20,000.00.

valuable in law and by which he was rendered insolvent. Section 55-81, however, voids that transfer only "as to creditors whose debts shall have been contracted at the time it was made . . . ." In addition, § 544(b) of the Bankruptcy Code requires that the same creditor hold "an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title."

Uncontroverted evidence submitted by the trustee reveals that, when the debtor made his mortgage payments to the noteholders, he had at least four existing creditors -- Michael and Jennifer Fine, the Rusco Window Company, and the Ted Lansing Corporation. The mandate of § 55-81 is therefore met.[7] As for the condition found in § 544(b), both the Fines and the Rusco Window Company have filed proofs of unsecured claim in the debtor's bankruptcy case to which no objection has been made. The trustee thus can stand in their shoes, DiCello v. Jenkins (In re International Loan Network, Inc.), 160 B.R. 1, 18 (Bankr. D.D.C. 1993), and can avoid the voluntary conveyance to the tenancy by the entirety for the benefit of all creditors, Moore v. Bay (In re Sassard & Kimball, Inc.), 284 U.S. 4 (1931); 5 Collier on Bankruptcy ¶ 544.09[5] (Lawrence P. King et al. eds., 15th ed. rev. 1996).

The Trustee's Remedy under § 550(a)

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[7] Having so concluded, the court does not have to consider whether the transfer constitutes a fraudulent conveyance under Va. Code § 55-80. Nevertheless, the court notes that the trustee did not appear to have established that the Meyers intended to defraud their other creditors by paying off the mortgage notes.

11 U.S.C. § 550(a) provides that, "to the extent that a transfer is avoided under section 544 . . ., the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property . . . from the initial transferee . . . ." Since the court already has found that the "initial transferee" of the debtor's "second transfer" was the tenancy by the entirety, the only question is "which remedy the trustee should receive." Kepler v. Security Pac. Hous. Servs. (In re McLaughlin), 183 B.R. 171, 176 (Bankr. W.D. Wis. 1995). Where the record contains no conflicting evidence of the property's value, courts generally have ordered that the property be returned. Id. In contrast, if the property cannot be recovered or if the property's value has been diminished by depreciation or the conversion, the trustee has been awarded the market price. Id. at 177. This proceeding presents an interesting twist in that the debtor transferred only a limited amount of equity in the real property. Since this equity cannot be "returned" under § 550(a), the court will enter a joint and several judgment against the Meyers for the $168,211.65 paid to the banks and will impose an equitable lien on the real property to secure payment of that amount to the trustee. See Kapila v. Covino, 187 B.R. 773, 779 (Bankr. S.D. Fla. 1995).

In his complaint, the trustee asked that pre-judgment interest from February 28, 1994, be included in any monetary award granted by the court. Of course, post-judgment interest need not be specifically requested since 28 U.S.C. § 1961(a) adds it to any federal court money judgment entered in an action otherwise governed by state law. Pereira v. Private Brands, Inc. (In re Harvard Knitwear, Inc.), 193 B.R. 389, 399 (Bankr. E.D.N.Y. 1996). The

propriety of pre-judgment interest in a § 544(b) proceeding, however, must be determined in accordance with state law. See Hayes v. Palm Seedlings Partners (In re Agricultural Research & Tech. Group, Inc.), 916 F.2d 528, 541 (9th Cir. 1990); Kendall v. Sorani (In re Richmond Produce Co.), 195 B.R. 455, 465 (N.D. Cal. 1996); see also Citizens Fed. Bank v. Cardian Mortgage Corp. (In re Cardian Mortgage Corp.), 122 B.R. 255, 264 (Bankr. E.D. Va. 1990).

Va. Code § 8.01-382 provides that a court in its discretion may award pre-judgment interest in order to "compensate the plaintiff who has been without relief for an extended period of time." Gill v. Rollins Protective Servs. Co., 836 F.2d 194, 198 (4th Cir. 1987). This court traditionally has awarded interest on a money judgment absent some compelling reason to do otherwise. The Meyers have proffered none in this proceeding, and therefore, the trustee's request for pre-judgment interest[8] from February 28, 1994, will be granted.

The Trustee's Power to Sell the Real Property

As a final matter, the court must rule on the trustee's request that the Meyers' real property be sold. When the debtor filed for bankruptcy, his undivided one-half interest in the residential real property became part of the estate pursuant to 11 U.S.C. § 541. In re Harry, 151 B.R. 735, 737 (Bankr. W.D. Va. 1992). Even though the debtor has claimed this interest as exempt under 11 U.S.C. § 522(b)(2), the trustee can administer the entireties property for

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[8] Pursuant to Va. Code § 6.1-330.54, prejudgment interest shall run at the judgment rate of 9%.

the benefit of creditors who could reach that property under state law. Williams v. Peyton (In re Williams), 104 F.3d 688, 689-90 (4th Cir. 1997); Sumy v. Scholossberg, 777 F.2d 921 (4th Cir. 1985).

Virginia law provides that property held by a couple as tenants by the entirety can be attached by their joint creditors. In re Williams, 104 F.3d at 690; Price v. Harris (In re Harris), 155 B.R. 948, 949 (Bankr. E.D. Va. 1993); In re Shelton, 201 B.R. 147, 152 (Bankr. E.D. Va. 1996). The evidence at trial established that the Meyers own their residence free and clear of any encumbrances except for accrued but unpaid real estate taxes and the equitable lien imposed by this court in favor of the trustee. Since the Meyers remain jointly liable for both these debts, the trustee has standing to request that the entire parcel be sold pursuant to 11 U.S.C. § 363(h) and that the proceeds be used to pay the outstanding taxes and the judgment entered in this proceedings.

Section 363(h) provides that the trustee may sell both the estate's interest and the interest of any co-owner only if –

> (1) partition in kind is impracticable;
>
> (2) sale of the estate's undivided interest would realize significantly less for the estate than sale of such property free of the interests of such co-owners;
>
> (3) the benefit to the estate of a sale free of the interests of co-owners outweighs the detriment to such co-owners; and

(4) the property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

Since the parties agree that subsection (4) does not apply in this proceeding, the court only needs to decide whether the first three conditions have been met.

A family home cannot be divided. Any sale of only the debtor's interest inevitably would leave Mrs. Meyer's possessory interest intact and a buyer unable to assume physical control of the house. The court therefore finds partition impracticable. See 3 Collier on Bankruptcy ¶ 363.08[1] (Lawrence P. King et al. eds., 15th ed. rev. 1996).

For the same reason, the court finds that a sale of only the debtor's interest would realize "significantly less" than a sale of the whole. With a buyer being denied possession, selling the debtor's interest alone would be tantamount to selling only his right of survivorship. See id. at ¶ 363.08[2][c]. Without question, such a sale would generate little, if any, benefit for the estate.

As for the balancing test in § 363(h)(3), the court recognizes that "non-economic, emotional or psychological detriment" should be considered "in addition to any economic detriment that may be suffered by the co-owner." Price v. Harris (In re Harris), 155 B.R. 948, 950 (Bankr. E.D. Va. 1993). Other than the fact that their home sits on the real property, which is not unusual in a bankruptcy case, the Meyers have offered no evidence of any particular

harm which a sale would cause Mrs. Meyer. Nevertheless, since this court's ruling on an unsettled question of law has provided the basis for the trustee's motion to sell, the Meyers shall have 30 days to explore other avenues for satisfying the judgment immediately and in full. If they do not suggest a viable alternative within that time, the court will permit the trustee to sell the real property.

Conclusion

In light of this opinion, the court will enter joint and several judgment against the Meyers and in favor of the trustee for $168,211.65, plus interest at the rate of 9% from February 28, 1994, until the date this judgment is entered. In addition, the court will impose an equitable lien on the real property to secure payment of that amount and will set the procedure by which the trustee can pursue his motion to sell.

Signed this 24th day of March, 1997.

/s/ Douglas O. Tice, Jr.
DOUGLAS O. TICE, JR.
UNITED STATES BANKRUPTCY JUDGE

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UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

IN RE ARNOLD I. MEYER Case No. 95-32427-T

Debtor Chapter 7

HARRY SHAIA, JR., TRUSTEE
Plaintiff

v.
Adv. Proc. No. 96-3006-T

ARNOLD I. MEYER and
NAOMI A. MEYER
Defendants

ORDER

On November 4, 1996, the court held a trial on the trustee's complaint and then took the ruling under advisement. For the reasons set forth in the memorandum opinion accompanying this order,

IT IS ORDERED that a joint and several judgment is entered against the defendants and in favor of the trustee for $168,211.65, plus interest at the rate of 9% from February 28, 1994, until the date this judgment is entered; and

IT IS FURTHER ORDERED that an equitable lien is imposed on the defendants' residential real property to secure payment of this judgment; and

IT IS FURTHER ORDERED that the defendants shall have 30 days from the date this order is entered to file with the court a proposed order which provides for the judgment to be satisfied immediately and in full.

Signed this 24th day of March, 1997.

/s/ Douglas O. Tice, Jr.
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11 U.S.C. § 522(b)(2000)

(b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Federal Rules of Bankruptcy Procedure, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (2) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is –

> (1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,
>
> (2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable of the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.